

**Status and impact of the ability to pay principle in the
ECJ's case law concerning tax benefits based on
personal and family circumstances**

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Abstract

Ability to pay is recognized in most Member States as a constitutional parameter to design fair tax systems and foundations of such principle can be found also in EU primary law. However, our investigation, based on the analysis of the ECJ's case law concerning tax benefits related to personal and family circumstances, will demonstrate that ability to pay can't be considered a general principle of the European legal order. Indeed, ability to pay requires taxpayers' personal and family circumstances to be taken into account once somewhere. On the contrary, the European Judges seem to recognize such principle only as a tool to avoid disadvantages for individuals exercising one of the fundamental freedoms granted by the Treaty, while accepting double-dips situations.

List of Abbreviations

AG	Advocate General
Art.	Article
Artt.	Articles
ECJ	European Court of Justice
FT	Fractional Taxation
I.e.	<i>Id est</i> (that is)
N.	Number
OECD	Organisation for Economic Co-operation and Development
OECD Model	Model Tax Convention on Income and on Capital
OJ	Official Journal of the European Union
P.	Page
Para.	Paragraph
Paras.	Paragraphs
Pp.	Pages
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
Vol.	Volume

1.Introduction

1.1 Status of the ability to pay in the EU: still a question with no answer

For many years the Netherlands, in order to attract foreign high-skilled expatriates, has granted them an exemption of 30% of the employment income earned in that country. The purpose of such benefit was to compensate those workers for the additional expenses related to their temporary stay in the Netherlands.¹ However, the 30% exemption applies regardless of the real costs incurred. In 2012 to limit the reverse discrimination arising from such rule in respect to Dutch residents, the 30% wage tax facility has been abolished for those foreign employees residing within a radius of no more than 150 km from the Dutch border, recognizing them the possibility to exempt only the remuneration for the "extra-territorial expenses" actually incurred.² The Dutch Supreme Court has recently asked for a preliminary ruling concerning the compatibility of such amendment with the free movement of workers and the case is at the moment pending in front of the ECJ.³

In essence, the European Judges are called upon to decide to what extent Member States can introduce a measure discriminating between non-residents⁴ in order to mitigate the distortive effects of a reverse discrimination. The outcome of the judgment will therefore depend, ultimately, on the possibility to characterize the need to limit the 30% wage tax facility as an overriding reason of general interest. While reverse discriminations seem to be accepted by the Court, an argument pointing towards the need to review the parameters to grant the 30% exemption (or even towards its abolition) could be found in the ability to pay principle, being such relief granted only to expatriates, regardless of the real expenses incurred. But can that principle be considered a source of EU tax law?

Ability to pay is recognized in most Member States as a constitutional parameter to design fair tax systems. However, in cross-border situations, where more than one jurisdiction is involved, the correct application of that principle is put at risk and its relevance becomes controversial. The aim of this work has been therefore to find out, analyzing the ECJ's case law concerning tax benefits based on personal and family circumstances, if the ability to pay can be considered a general principle of the European order and, accordingly, a self-standing source of law. In particular, the value and binding force of the ability to pay have been tested against the non-discrimination principle in judgments dealing with the protection of fundamental freedoms granted by the Treaty.

1.2 Background

According to the ability to pay principle, taxpayer's fiscal burden should reflect his/her capacity to contribute to public spending. Income is usually considered to be the best measure for such

¹ Smit D., 'The 150km Requirement under the Dutch 30% Wage Tax Facility C-512/13 (Sopora)', in Lang and others, *ECJ – Recent Developments in Direct Taxation 2013*, Linde, 2013, p. 132.

² Ibid.

³ Case C-512/13, *Sopora* (pending)

⁴ As Smit points out, discrimination would arise in those cases where both expatriates fulfilling the 150 km requirement and expatriates not fulfilling it move to the Netherlands, being therefore in comparable situations but subjected to different tax treatments.

capacity, however, as our analysis will later point out, there are also other parameters that can be used for the same purpose.⁵

When income is chosen as individuals' ability to pay indicator, personal and family circumstances of the taxpayer should be considered to reduce that net amount, since they constitute a limiting factor for the capacity of contributing to public expenditures. Therefore, most countries grant some tax relief in order to take into account the existence of children, marital status or specific expenses linked to personal needs of the taxpayer (such as medical expenses).⁶ However, when more than one jurisdiction is involved in the taxation of a single taxpayer, the correct application of such aspect of the ability to pay principle is put at risk.⁷ Indeed, from a European Market point of view, taxpayer's personal circumstances should be taken into account once but not more than once. This way, the tax burden would reflect his overall economic capacity and at the same time the exercise of fundamental freedoms won't be discouraged or used as a stratagem for escaping taxation through mismatches between the countries involved.⁸ This outcome should not, however, be given for granted.

The concept of ability to pay presupposes a full and comprehensive recognition of income, which doesn't cause any problems in single-country situations.⁹ Indeed, when only one tax authority is called to assess and tax the whole income of a certain taxpayer, it will take into account all his/her relevant income-generating activities and personal circumstances.¹⁰ On the contrary, complications arise and the relevance of the principle becomes controversial with reference to cross-border situations.

The main issue consists in the fact that Member States design taxation of resident and non residents to meet different needs. Residents are generally taxed by the home State according to their ability to pay and therefore, since the latter is not limited by geographical or political borders,¹¹ by reference to their worldwide income. Taxation of non residents, on the contrary, doesn't have such global outreach, being based on a benefit principle. According to this principle, fiscal contributions are proportionate to the benefits (business opportunities and serviced offered)¹² enjoyed by taxpayers thanks to the participation in the market provided by the source State.¹³ The residence State is, indeed, deemed to be in a better position when it comes to gaining complete knowledge of taxpayer's situation, including his personal and family circumstances, while source States may face practical difficulties in the assessment of non residents due to the lack of information and therefore don't grant personal allowances to those taxpayers.¹⁴ At the

⁵ IBFD glossary "ability to pay".

⁶ Bardini C., 'The ability to Pay in the European Market: An Impossible Sudoku for the ECJ', in *Intertax*, vol. 38, n. 1, 2010, p. 4.

⁷ Ibid p. 2.

⁸ Ibid p. 4.

⁹ Schoen W., 'International Tax Coordination for a Second-Best World (PartI)', in *World Tax Journal*, vol. 1, n. 1, 2009, p. 72.

¹⁰ Ibid.

¹¹ Ibid.

¹² Bardini (n. 6), p.4.

¹³ Moessner M., 'Source versus Residence - an EU Perspective', in *Bulletin for International Taxation*, vol. 60, n. 12, 2006, p. 505.

¹⁴ Wattel P.J., 'Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Asscher, Gilly and Geschwind Do Not Suffice', in *European Taxation*, vol. 40, n. 6, 2000, p. 215.

same time, the jurisdictional power of the source country to tax income economically linked to its territory cannot be denied.¹⁵

It should be mentioned here that withholding taxes, being taxes on income imposed at source, are *per se* inconsistent with the ability to pay principle, but seem to be tolerated by the ECJ. In *Gerritse* the Court stated that the Treaty doesn't preclude a national legislation subjecting non residents to a withholding tax at a uniform rate, while residents are taxed according to a progressive table on basis of a tax assessment.¹⁶ Condition for this compatibility was, however, that the flat rate was not higher than what would have been applied to the person concerned in accordance with the progressive table.¹⁷ The ECJ therefore didn't pay much attention to the fact that residents are taxed on their worldwide income whereas non residents are taxed only on the part of their total income earned in the source State.¹⁸ Later, the European Judges stroke down withholding taxation when applied only in respect of situations having a cross-border element, but held the discriminatory character of the national provisions at issue justified by the need to ensure the effective collection of income tax.¹⁹ However, the position of the ECJ on whether or not withholding taxes should be considered admissible following the implementation of the Mutual Assistance Directive²⁰ is not completely clear²¹ and might evolve in the future towards a more restrictive approach.

The scenario is particularly complex when personal circumstances concur to determine an income subjected to progressive taxation. In those cases, the ability to pay principle can be put to risk in cross-border situations. Indeed, progressivity of tax rates can be seen as an expression of the ability to pay principle,²² starting from the assumption that marginal utility of income is inversely proportional to the amount of the latter.²³ Therefore, international tax law can be held inconsistent with the ability to pay principle because generally only home States calculate progression of tax brackets on the basis of worldwide income, while host States only take into consideration source income for this purpose.²⁴

Due to the mismatches between source and residence State, thus, in cross-border cases personal and family circumstances can be ignored by the tax systems of all States involved or, on the contrary, determine the recognition of fiscal benefits in more than one country. As a consequence, the ability to pay principle is infringed upon. Indeed, the principle is useful to identify the income as such but doesn't indicate which part of it should, in such cases, be subject to tax in the country of residence and which in the country of source.²⁵ To use Schoen's word, "*ability to pay helps to define the cake but it does not help to slice it*".²⁶

¹⁵ Schoen (n. 9), p. 73.

¹⁶ Case C-234/01, *Arnoud Gerritse v Finanzamt Neukölln-Nord*, 12 June 2003, EU:C:2003:340, para. 55.

¹⁷ Ibid.

¹⁸ Moessner (n. 13), p. 504.

¹⁹ Case C-290/04, *FKP Scorpio Konzertproduktionen GmbH v Finanzamt Hamburg-Eimsbüttel*, 3 October 2006, EU:C:2006:630, para. 35.

²⁰ Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, OJ L336/15.

²¹ See, to this regard, Simader K., 'Withholding Taxes and the Effectiveness of Fiscal Supervision and Tax Collection', in *Bulletin for International Taxation*, vol. 64, n. 2, 2010, pp. 115 and following.

²² For a critical view on this point see Gunnarsson Å., *Skatterättsvisa*, Umeå University, Faculty of Social Sciences, Law, 1995.

²³ Chand S.N., *Public Finance*, Atlantic, 2008, p. 119.

²⁴ Wattel (n. 14), p. 210.

²⁵ Moessner (n. 13), p. 505.

²⁶ Schoen (n. 9), p. 73.

1.3 Purpose

In the light of the above mentioned issues, some clarification of the status of the ability to pay principle is required. According to some authors ability to pay cannot be considered a valid parameter for allocating taxing powers between Member States,²⁷ while other doctrine has been taking an opposite position.²⁸ Despite the different and multilateral approaches that can be taken, the fundamental question that needs to be answered in order to assess the impact of ability to pay in international taxation is whether it can be characterized as a general principle of EU law.

If the answer is found to be negative, since direct taxation is not an harmonized area, Member States remain free to tax companies, individuals and situations under the only condition of the existence of a genuine link (just like residence, nationality and source of income) with them.²⁹ Should this be the outcome of our analysis, a series of other issues and question marks would arise and require further investigations. Just as an example of the implications of this scenario and of their criticality, a quick hint can be given at the Italian situation. Art. 53 of the Italian Constitution contains a general and absolute principle according to which taxpayers should concur to public expenditures on basis of their ability to pay and with respect of progressivity criteria, constituting a guiding line of the whole tax system. The importance of this rule is highlighted by its clear and direct formulation, which doesn't leave any discretion to the interpreter (*in claris not fit interpretatio*).³⁰ According to the case law of the Corte Costituzionale³¹ the limitations of the Italian sovereignty deriving from the participation to supranational organizations are not allowed when they are able to breach the fundamental rights of the individuals or the fundamental principles of the Italian constitutional order.³² Since there is no doubt that the ability to pay principle stated in art. 53 is one of the latter, being strictly connected with art. 2 (inviolable rights of men) and art. 3 (equality principle) of the Italian Constitution, the tension that might arise between national and supranational legal order from non characterizing the ability to pay as a general principle of EU law is evident. Even if this is not the appropriate place to discuss the possible resulting implications of a similar situation, their seriousness can easily be foreseen: Community law incompatible with the ability to pay could not be applied in the Italian territory.

On the contrary, if ability to pay is to be considered as a general principle of the European order, national and/or supranational solutions would be required to make sure that, in particular, personal and family circumstances of the taxpayer are taken into account once (and only once) in one of the Member States involved in cross-border situations. In this hypothesis the principle would be binding for both Member States and European institutions. National legislators should

²⁷ Easson A., 'Fiscal degradation and the inter-nation allocation of tax jurisdiction', in *EC Tax Review*, vol. 3, 1996, pp. 112-113.

²⁸ Vogel K., 'Worldwide vs. source taxation of income- A review and re-evaluation of arguments (part I)', in *Intertax*, vol. 16, 1988, pp. 216 and following.

²⁹ Moessner (n. 13), p. 505.

³⁰ Russetti D., 'L'incerta incompatibilità tra diritto comunitario e art. 53 della Costituzione', p. 2, available at http://www.forumcostituzionale.it/site/images/stories/pdf/documenti_forum/paper/0110_russetti.pdf (accessed 30 March 2014).

³¹ See, in particular, Corte Costituzionale sentenza 27 December 1973, n. 183 and sentenza 25 May 1989, n. 232.

³² Dicosola M., 'The Essence of Constitutional Rights in Italy', University of Trento, A Summer School on Comparative Interpretation of European Constitutional Jurisprudence, 2006, available at <http://www.jus.unitn.it/cocoa/papers/PAPERS%201ST%20PDF/The%20essence%20of%20constitutional%20rights/Italy-essence.pdf> (accessed 28 March 2014).

make sure and comply with it when drafting tax laws and taxpayer could use it as a basis for their claims. It's interesting to mention that if ability to pay is found to be a general principle of EU law, according to some doctrine,³³ a tension could be identified between that principle and the Community financing system, which is based, *inter alia*, on a percentage of national income.³⁴ Indeed, statutory ability to pay derives from single taxpayers' ability to pay. A breach of this principle could be identified if considering that individuals or companies from richer countries contribute more to EU resources compared to taxpayers with equal or even higher ability to pay but residing in countries contributing in a lower amount to the Community budget.

In the light of the importance of the above mentioned observations and lack of clarity on the described issues, the purpose of this work is to find out whether ability to pay is a general principle of EU law. Such investigation constitutes a necessary step to take for assessing the value of ability to pay as a source of European tax law and, as a consequence, its impact and binding force.

We are aware that Prof. Englisch has been recently conducting a similar research³⁵ and we have used his work as a starting point to then assess concretely, through case law analysis (even if limited to the field of personal tax benefits), the constitutional relevance of the ability to pay principle he has been hypothesizing. Our contribution will therefore be to develop his work and verify if the ECJ has been effectively recognizing and implementing that principle. The value of the ability to pay, in particular, will be tested against the non-discrimination principle in cases relating to fundamental freedoms.

1.4 Method and materials

The leading question of our research is a legal dogmatic one: can ability to pay be considered as a general principle of EU law and, therefore, a source of law? The analysis has been conducted following a legal method, aimed at assessing the law as it stands today.

The materials used have been mainly the case law of the European Court of Justice (at the 10th of May 2014), doctrinal articles and literature, almost entirely in English. However, due to the complexity of the topic, references to some economic theories and public finance concepts have been necessary to explain content and meaning of the ability to pay principle.

Moreover, even if this thesis is focused on international tax law, one of the theories concerning the coercive force of general principles had to be chosen as basis for our analysis. For the purposes of this work, an intermediary theory developed by Dworkin has been preferred to positivism, naturalism and realism. According to him, principles form part of the law and judges should rely on those, and not on arguments of policy, for rendering the legal system coherent. The latter is seen as a perfect concept (integrity of law) and therefore reliance on principles doesn't imply any judicial law-making process, since judges don't have any discretion when deciding cases.³⁶ Such approach is the one preferred by the author of this thesis and it will therefore be used as point of departure of our investigation. Indeed, Dworkin's theory recognize

³³ Russetti (n. 30), p.1

³⁴ European Commission, *Financial Programming and budget*, available at http://ec.europa.eu/budget/explained/budg_system/financing/fin_en.cfm#own_res (accessed 2 April 2014)

³⁵ Englisch J., *Ability to pay*, forthcoming.

³⁶ Groussot X., *Creation, Development and Impact of the General Principles of Community Law: Towards a jus commune europaeum*, Lund, 2005, p. 189.

the legal value of general principles and, at the same time, it is more in line with the principle of legal certainty and with the assumption that judicial and legislative power should be kept separate. The power to create law should be in the hands of subjects representing citizens and elected by them.

1.5 Delimitation

Considering the wide scope of an investigation on the status and impact of the ability to pay principle in European tax law, our analysis will be subject to several delimitations.

First, among the cases dealt with by the Court of Justice, the chosen research area consists only of those relating to direct taxation of individuals. More specifically, only the judgments concerning tax benefits based on personal and family circumstances will be considered. Indeed, they provide a significant sample for showing complexity of the topic and difficulties faced by the Court of Justice in granting respect of the ability to pay principle in cross-border situations. Fiscal benefits relating to personal and family circumstances of the taxpayer are granted by Governments of each Member State on basis of different objectives, such as to remain neutral or to encourage couples to get married, to influence their joint or single participation in the working force and so on.³⁷ These objectives are strictly related to economic, sociological, political and even cultural features of each country and therefore can differ considerably and even conflict with each other. Accordingly, Member States have adopted a great variety of solutions in order to respect the ability to pay principle through the grant of tax benefits relating to taxpayers' personal and familiar situations. Such variety probably fostered the fluctuating attitude of the European Judges during the years and, at the same time, might explain the more restrictive and careful approach to the principle followed in cross-border situations, compared to the one adopted in purely domestic cases. Indeed, as we will see, the principle of ability to pay in an EU context requires personal and family circumstances to be taken into account once somewhere. Within national systems, on the contrary, the status of resident automatically implies the full recognition of all personal-related allowances and deductions.

Personal and familiar tax advantages is an EU law concept, however depending on the concretion by the different tax treaties and domestic laws, and therefore varies significantly from State to State.³⁸ The elements identifying this concept are not clear, since the Court of Justice has been giving confusing indications in its case law. For this reason, before moving on to the core part of our analysis, it is necessary to clarify what will and will not be considered under the category of personal and family circumstances.

In *Lakebrink* the ECJ has defined personal and family circumstances as "all the tax advantages connected with the non-resident's ability to pay tax which are not taken into account either in the State of residence or in the State of employment".³⁹ The definition adopted by the author of this work will be, however, limited to some of the fiscal instruments able to affect families, i.e. to "affect the difference between the gross and net income of a single persons, married couples or married parents".⁴⁰ Such provisions can be divided into three categories. The first includes

³⁷ Messere K., 'Taxing and Aiding EU Families', in *European Taxation*, vol. 43, n. 12, 2003, p. 443.

³⁸ Richelle I., Schoen W. and Traversa E., *Allocating Taxing Powers within the European Union*, Springer, 2013, p. 18.

³⁹ Case C-182/06, *État du Grand Duchy of Luxembourg v Hans Ulrich Lakebrink and Katrin Peters-Lakebrink*, 18 July 2007, EU:C:2007:452, para. 34.

⁴⁰ Messere (n. 37), p. 444.

provisions dealing with the tax unit, which means the possibility of taxing two spouses separately (individual taxation) or on base of their aggregate income (family taxation or joint taxation depending on the fact that the income of dependant subjects is included or not).⁴¹ The second category is composed by tax reliefs, that can be qualified as "personal expense deductions" (related to some particular types of personal expenses, such as charitable contributions) or as "person-related tax reductions" (related to the civil status of the taxpayer or other personal aspects as, for instance, the fact that he has minor children).⁴² Those person-related tax benefits can be qualified as tax allowances when the income is reduced by deductions of certain amounts or as tax credits if the deductions reduce the tax due to be paid.⁴³ Finally, the last category of fiscal provisions able to affect families consist of tax-free cash transfers, related in different ways to the number and age of children in the household.⁴⁴

Furthermore, the focus of our analysis will be limited to the so called *subjective* ability to pay, which is the one that comes into play only after taxpayer's basic personal needs have been satisfied⁴⁵ and that takes therefore into account his personal and family circumstances.⁴⁶ On the contrary, *objective* ability to pay implies that taxation must be based on net gains, requiring therefore the amount of income to be reduce by all costs and losses incurred to earn it.⁴⁷ This aspect of the principle won't be taken into account by our investigation, thus *Gerritse*,⁴⁸ *Lakebrink*⁴⁹ and *Renneberg*,⁵⁰ where the ECJ considered tax treatment of business expenses and foreign losses as a personal fiscal benefit,⁵¹ won't be analyzed. For the purpose of this thesis, we will identify personal and family circumstances through their link to the individual as a whole and not to particular items of income.⁵² For this reason, the *Hirvonen*⁵³ pending case has been also left aside, together with *Bouanich*⁵⁴ and *Ritter-Coulais*,⁵⁵ both dealing with objective ability to pay but where no reference has been made by the Court to the personal circumstances of the taxpayer.

Rulings concerning inheritance taxes have also been left out of our investigation. In those, the ECJ has never used the formula "personal and family circumstances" and, even if sometimes the taxpayer's personal and familiar situation was relevant to determine the fiscal treatment at issue in these cases (see, for instance, *Welte*),⁵⁶ the category of such judgments is much wider and deals

⁴¹ Ibid pp. 444-445.

⁴² Van Raad K., 'Non -Residents - Personal Allowances, Deduction of Personal Expenses and Tax Rates', in *World Tax Journal*, vol. 2, n. 2, 2010, p. 155.

⁴³ Messere (n. 37), p. 445.

⁴⁴ Ibid.

⁴⁵ Crespo C., 'The "ability to pay" as a fundamental right: rethinking the foundations of tax law', in *Mexican Law Review*, vol. 3, n. 1, 2010, pp. 60-61.

⁴⁶ Bardini (n. 6), p. 4.

⁴⁷ Crespo (n. 45), p. 60.

⁴⁸ Case C-234/01, *Arnoud Gerritse v Finanzamt Neukölln-Nord*, 12 June 2003, EU:C:2003:340.

⁴⁹ *Lakebrink* (n. 39).

⁵⁰ Case C 527/06, *R. H. H. Renneberg v Staatssecretaris van Financiën*, 16 October 2008, EU:C:2008:566.

⁵¹ For a critical view on this case law see Meussen G., 'Renneberg: ECJ Unjustifiably Expands Schumacker Doctrine to Losses from Financing of Personal Dwelling', in *European Taxation*, vol. 49, n. 4, 2009, pp. 185 and following.

⁵² Bardini (n. 6), p. 8.

⁵³ Case C-623/13, *Hirvonen* (pending).

⁵⁴ Case C-375/12, *Margaretha Bouanich v Direction départementale des finances publiques de la Drôme*, 13 March 2014, EU:C:2014:138.

⁵⁵ Case C-152/03, *Hans-Jürgen Ritter-Coulais, Monique Ritter-Coulais v Finanzamt Germersheim*, 21 February 2006, EU:C:2006:123.

⁵⁶ Case C-181/12, *Yvon Welte v Finanzamt Velbert*, 17 October 2013, EU:C:2013:662.

with deductions and allowances relating to a specific type of income (falling therefore under the scope of objective ability to pay).

The choice of analyzing only the subjective aspect of the ability to pay, necessarily implied the exclusion of corporate taxation from our field of research. However, it should be mentioned that there is a number of judgments constituting a fertile ground for an investigation on the status and impact of ability to pay in cases relating to loss relief and deduction of costs in cross-border situations (see, for instance, *Marks & Spencer*,⁵⁷ *Deutsche Shell*,⁵⁸ and *Lidl Belgium*).⁵⁹

Moreover, the scope of our analysis doesn't include those cases that specifically concern the fiscal situation of spouses of EU servants (*Gisto*,⁶⁰ *Schulz-Delzers and Schulz*).⁶¹

Finally, only cases with a cross-border element will be analyzed (*Werner*⁶² will therefore be excluded), and in particular those where only Member States were involved (and this is why *Ettwein*⁶³ won't be touched upon).

1.6 Outline

Following the introduction, an analysis of the ability to pay principle will be presented. In particular, after a brief reflection on the role of general principles within EU law, an attempt will be made to clarify content and meaning of the ability to pay. Later, possible foundations of the principle in EU law will be highlighted. Chapter 3, constituting the core of our analysis, will provide an overview of the selected Court of Justice case law concerning tax benefits based on personal and family circumstances and some comments on the relevance of the ability to pay principle in those rulings. In Chapter 4, limits of the negative integration activity of the ECJ in the field at issue will be underlined. Some considerations will follow, regarding the problematic role of tax treaties in building an EU fiscal system in line with ability to pay and the possible solution provided for by fractional taxation. Finally, the author's conclusions will be presented.

2. The ability to pay principle

2.1 The role of general principles in the EU

General principles form part of primary EU law and they play a key role in the development, interpretation and application of European tax law.⁶⁴ The term *principles*, from the Latin *principia*, literally indicates the starting points, and therefore some primordial norms, premises or initial

⁵⁷ Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)*, 13 December 2005, EU:C:2005:763.

⁵⁸ Case C-293/06, *Deutsche Shell GmbH v Finanzamt für Großunternehmen in Hamburg*, 28 February 2008, EU:C:2008:129.

⁵⁹ Case C-414/06, *Lidl Belgium GmbH & Co. KG v. Finanzamt Heilbronn*, 15 May 2008, EU:C:2008:278.

⁶⁰ Case C-270/10, *Lotta Gistö*, 28 July 2011, EU:C:2011:529.

⁶¹ Case C-240/10, *Cathy Schulz-Delzers and Pascal Schulz v Finanzamt Stuttgart III*, 15 September 2011, EU:C:2011:591.

⁶² Case C-112/91, *Hans Werner v Finanzamt Aachen-Innenstadt*, 26 January 1993, EU:C:1993:27.

⁶³ Case C-425/11, *Katja Ettwein v Finanzamt Konstanz*, 28 February 2013, EU:C:2013:121.

⁶⁴ Helminen M., *EU Tax Law – Direct Taxation*, Online Books IBFD, 2013.

sources.⁶⁵ The qualification as *general*, in contradistinction with *specific*, refers to their comprehensiveness, diversity of objects and amplitude of normative scope.⁶⁶

According to Dworkin, principles can be defined as standards to be observed not because securing a desirable political, social or economic outcome, but because constituting a requirement of fairness, justice, or of some other dimension of morality.⁶⁷ In Dworkin's opinion principles are part of the law just like rules, but differ from those because they are not applicable in an all-or-nothing way: principles give reasons for deciding cases, but not conclusive ones.⁶⁸ Indeed, there can be different principles applicable in a certain situation, and in that case the judge will have to balance them. Rules, on the contrary, do not conflict with each other.⁶⁹

However, not all principles constitute general principles of EU law. General principles form a particular class of normative principles which are, in the same way, a particular category of the concept of principle (together with doctrinal and moral principles).⁷⁰ General principles and principles have a different degree of generality. Accordingly, more specific principles can be used to back up general ones and, at the same time, a number of more specific principles can be derived from the same general principle.⁷¹ Moreover, general principles apply to a wider range of situations and are often implemented, in practice, by specific legislative or treaty measures, which, however, can only confirm and never take away their status of *leges generales*.⁷²

The main role of general principles is to indicate how to interpret ambiguous norms and to give guidance to judges on how to solve problems not expressly covered by rules.⁷³ The importance of such gap-filling function of general principles is due to the necessarily incomplete character of the European legal order.⁷⁴ Another function boasted by general principles is to determine the legality of the acts of the Community institutions and of the Member States,⁷⁵ sometimes even supporting claims for damages. In particular, general principles can be invoked by individuals and States to challenge actions of the Community⁷⁶ and, by individuals, to challenge actions of Member States.⁷⁷ Such functions would therefore be performed also by the ability to pay, in case it would be deemed to be a general principle of EU law.

⁶⁵Bernitz U., Groussot X. and Schulyok F., *General Principles of EU Law and European Private Law*, Kluwer Law International BV, 2013, p. 46.

⁶⁶ Ibid.

⁶⁷ Dworkin, *Taking Rights Seriously*, Duckworth, 1996, p. 22, in Groussot X., *Creation, Development and Impact of the General Principles of Community Law: Towards a jus commune europaeum*, Lund, 2005, p. 192.

⁶⁸ Groussot X., *Creation, Development and Impact of the General Principles of Community Law: Towards a jus commune europaeum*, Lund, 2005, p. 192.

⁶⁹ Dworkin, *Taking Rights Seriously*, Duckworth, 1996, p. 22.

⁷⁰ Groussot (n. 68), p. 193.

⁷¹ For instance, the principle of legal certainty justifies legitimate expectations and non-retroactivity. See Groussot (n. 68), p. 193.

⁷² Bernitz (n. 65), p. 70.

⁷³ Avery Jones J., 'Tax Law: Rules or Principles?', in *Fiscal Studies*, vol. 17, 1996, p. 75.

⁷⁴ Groussot (n. 68), p. 40.

⁷⁵ AG Opinion in Case C-367/96, *Alexandros Kefalas and Others v Elliniko Dimosio (Greek State) and Organismos Oikonomikis Anasykrotisis Epicheiriseon AE (OAE)*, 12 May 1998, EU:C:1998:222, para. 19.

⁷⁶ See for instance Case 122/78, *SA Buitoni v Fonds d'orientation et de régularisation des marchés agricoles*, 20 February 1979, EC:C:1979:43, where the Court has declared art. 3 of Regulation No 499/76 invalid because conflicting with the principle of proportionality. Groussot (n. 68), p. 17.

⁷⁷ See for instance Case 222/84, *Marguerite Johnston v Chief Constable of the Royal Ulster Constabulary*, 15 May 1986, EU:C:1986:206, where the Court has recognized the possibility to set aside a national legislation which contains an

Finally, for sake of completeness, it should be mentioned that some principles can also regulate relationships between Community and national legal systems (this is the case, for instance, of the principle of supremacy).⁷⁸

2.2 Meaning and content of the ability to pay

Principles (unlike rules) often lack of a well-defined and precise content.⁷⁹ However, this paragraph will try to describe as precisely as possible what ability to pay means and how such principle should be interpreted.

Preliminary, it should be noted that ability to pay is only one of the possible approaches followed by policy makers to design fair tax systems. There are, indeed, two other major theories that could be used to determine the distribution of the burden of government finance.⁸⁰ The first, so called cost theory, states that persons should pay an amount of taxes that corresponds to the cost of the services of which they are beneficiaries.⁸¹ The main problem of this theory, consist of the difficulty (maybe even the impossibility) of measuring the cost of public services on a personal basis.⁸² A different view is shared by supporters of the benefit theory, according to which the tax burden should be proportionate to the benefit (i.e. the worth) of services and goods received by the taxpayer from the State.⁸³ In reality, however, it's not always possible to precisely measure those benefits. For instance, what is the benefit that a person derives from the maintenance of army?⁸⁴ Moreover, neither the cost nor the benefit theory take into account the redistributive aspect of taxation, because no distinction is made between taxpayer in different economic situations.⁸⁵ For those reasons, the most commonly accepted parameter to assess equity in taxation is the ability to pay principle.

The meaning of the ability to pay principle has been very discussed by scholars and the doctrinal debate has developed several ideas on the matter.⁸⁶ However, the fundamental idea behind the concept is that taxes should be levied on persons according to how well the latter can bear the burden,⁸⁷ without considering benefits accruing from public goods.⁸⁸ Thus, the ability to pay can be seen as a corollary of the equity principle, helping to substantiate the latter in the field of tax law⁸⁹ from two different points of view. On the one hand, it requires that richer taxpayers should pay more than the poorer ones (vertical equity); on the other, persons with similar abilities to pay should contribute in the same amount to public expenditures (horizontal equity).⁹⁰

derogation to the principle of equal treatment between men and women, exceeding the limits permitted by EU law (para. 57). Groussot (n. 68), p. 17.

⁷⁸ Groussot (n. 68), p. 27.

⁷⁹ Semmelmann C., 'General Principles in EU Law between a Compensatory Role and an Intrinsic Value', in *European Law Journal*, vol. 19, n. 4, 2013, p. 461.

⁸⁰ Kennedy M. J., *Public Finance*, PHI Learning Private Limited p. 51.

⁸¹ Ibid p.52

⁸²Ibid.

⁸³ Lettieri G., *Compendio di scienza delle finanze*, Maggioli Editore, 2011, p. 138.

⁸⁴ Kennedy (n. 80), p. 54

⁸⁵Ibid.

⁸⁶ Crespo C., 'The "ability to pay" as a fundamental right: rethinking the foundation of tax law', in *Mexican Law Review*, vol. 3, n. 1, p. 54.

⁸⁷ Mankiw N., *Principles of Economics*, Cengage Learning, 2014, p.247.

⁸⁸ Kennedy (n. 80), p.55.

⁸⁹ Crespo (n. 86), p. 54.

⁹⁰ Mankiw (n. 87), p.247.

After giving a definition of ability to pay principle, it is now time to face a second difficulty that arises when switching from a theoretical to a practical approach: how should the ability to pay be measured? Not the same view is shared by all economists. Some of them argue that an objective approach should be followed. Accordingly, the existence of ability to pay is recognized in presence of certain economic indexes, directly or indirectly linked to the taxpayer, which indicate his ability to contribute to public expenses.⁹¹ The most important of these factors is income, but property and consumptions expenditure can also be referred to. However, some economists sustain a different view, which refers to the concrete possibility of satisfying the tax obligation.⁹² Such subjective approach, on which our analysis is based, considers the psychological reactions of taxpayers to the imposition of the fiscal burden⁹³ and is in line with the principle of equal sacrifice. Such principle, however, can be interpreted in three different ways. Firstly, it can be understood as requiring the total loss of utility to be equal for all taxpayers (equal absolute sacrifice).⁹⁴ Moreover, such loss can be deemed to correspond to a percentage of the income of the taxpayer, which means that richer persons should be taxed more than poorer ones (equal proportional sacrifice).⁹⁵ Lastly, the principle of equal sacrifice can be interpreted as imposing that the marginal utility of income left after tax should be the same for any person.⁹⁶ According to this theory (so called of the equal marginal sacrifice), as a consequence of such taxation, the total sacrifice for the society would be maximum.⁹⁷ While equal absolute sacrifice can result in regressive taxation, both the last two approaches imply progressivity, which would be particularly marked in the equal marginal sacrifice scenario, determining higher percentages of income for taxes from high-income taxpayers.⁹⁸ It can also be noticed that the last described interpretation of the ability to pay principle is orientated towards the welfare state, since it aims at leveling incomes and net wealth.⁹⁹

Regardless of which approach is chosen, the essence of the sacrifice principle is that, as Mill said, in assessing the equity of a tax distribution, what matters is not the sum of money paid by the taxpayer in itself, but his loss of well-being.¹⁰⁰ This means that the size of the sacrifice depends not just on the amount of tax payments, but also on his income and other circumstances¹⁰¹ that might influence the impact of the fiscal duties on the well-being of a person, reducing the degree of private satisfaction of needs that he can achieve.¹⁰² Obviously, such circumstances include also those related to the taxpayer's personal and family situation (as, for instance, the burden to provide for his or her family).¹⁰³ In particular, as a consequence of the ability to pay principle, but also of human dignity, social justice and solidarity, the duty to contribute to public expenses should be limited to those resources of the taxpayer that exceed the so called "subsistence minimum", which means the expenses related to essential needs of the taxpayer and of his

⁹¹ Gerla L., *Compendio di diritto tributario*, Maggioli Editore, 2012, p. 19.

⁹² Ibid.

⁹³ Chand S.N., *Public Finance*, Atlantic, 2008, p. 84.

⁹⁴ Kennedy (n. 80), p.56

⁹⁵ Chand (n. 93), pp. 85-86.

⁹⁶ Ibid p.86

⁹⁷ Kennedy (n. 80), p.56.

⁹⁸ Rabin J., *Handbook of Public Budgeting*, Marcel Dekker, 1992, p. 280

⁹⁹ Gunnarsson Å., *Skatterättvisa*, Umeå University, Faculty of Social Sciences, Law, 1995, p. 295.

¹⁰⁰ Mankiw (n. 87), p.247.

¹⁰¹ Ibid.

¹⁰² Gunnarsson (n. 99), p. 295.

¹⁰³ Ibid.

dependent family members. Accordingly, personal and family deductions, exemptions and allowances should be guaranteed by Member States.¹⁰⁴

2.3 Possible foundations of the principle in EU law

Rodriguez Iglesias, President of the European Court of Justice, pointed out that general principles are to be found in international law, in laws common to the Member States, and sometimes in the Treaties.¹⁰⁵ Accordingly, he highlighted how the elaboration of such principles cannot be defined activism, but is on the contrary strictly judicial.¹⁰⁶

Concerning ability to pay, first of all, it should be observed that no reference to this principle can be found in EU Treaties.

As regards laws of Member State, it should be point out that in some EU countries this principle is explicitly guaranteed in the Constitution. In Italy, for instance, art. 53 of the Constitution states that "*everyone shall contribute to public expenditure in accordance with his (or her) means*". Similar provisions can be found in the Spanish and in the Greek Constitutions.¹⁰⁷ Moreover, the principle of ability to pay is recognized as constitutionally relevant in many other Member States, even without being directly formulated within the Constitution. This is the case, *inter alia*, of France, where art. 13 of the Declaration of the Rights of Men and the Citizen, whose constitutional value is recognized by the preamble of the French Constitution, requires common contributions to be divided among members of the community according to their abilities. In Germany, despite the lack of constitutionally relevant provisions relating to ability to pay, the case law of the Constitutional Court has considered it the main standard for testing tax legislation against the principle of equality provided for in art. 3 of the German Basic Law.¹⁰⁸

In other EU countries the ability to pay principle doesn't have constitutional rank but is, however, considered as an important guideline for drafting tax law. In Sweden, for instance, after the tax reform of 1991, several changes have been made to adjust individuals' fiscal burden to their overall ability to pay.¹⁰⁹

Generally speaking, even if the ability to pay principle is often criticized for its vagueness and susceptibility to ideological fallacies,¹¹⁰ it can be stated that all Member States have *de facto* implemented important elements of the ability to pay principle in their domestic tax legislations.¹¹¹ However, as Advocate General Tesouro mentioned in *Kefalas* "*the elaboration of a general principle at Community level does not necessarily require that the principle exist in all the national legal systems or that it be subject to the same conditions and application criteria. These are principles which must be*

¹⁰⁴ Englisch J., *Ability to pay*, forthcoming.

¹⁰⁵ Iglesias R., *Reflections on the General Principles of Community Law*, CJLS, 1999, pp. 15-16.

¹⁰⁶ Ibid.

¹⁰⁷ See art. 31.1 of the Spanish Constitution and art. 4.5 of the Greek Constitution.

¹⁰⁸ Bourgeois M., 'Constitutional Framework of the different types of income', in *The concept of tax*, EATLP Congress, Naples (Caserta), 2005, pp. 97-98.

¹⁰⁹ See Gunnarsson Å., 'Swedish Legal National Report: the use of taxation for non-fiscal purposes', in *Yearbook for Nordic Tax Research 2009: the non-fiscal purposes of taxation*, Jane Bolander, DJOFPublishing, 2009, p. 120 and *Challenging the Benchmarks in Tax Law Theories and Policies from a Gender Perspective—The Swedish Case*, in *Challenging Gender Inequality in Tax Policy Making: Comparative Perspectives*, Hart Publishing Ltd, 2011, p. 86

¹¹⁰ Schoen W., 'International Tax Coordination for a Second-Best World (PartI)', in *World Tax Journal*, vol. 1, n. 1, 2009, pp. 71-72.

¹¹¹ Englisch (n. 104).

*incorporated in the Community order and which, therefore, acquire their own autonomy in function of the structure and the objectives of that order".*¹¹² Also the ECJ itself has been stating that, when identifying general principles of law, the constitutional traditions common to Member States are only used as *inspiration*.¹¹³ The ability to pay could, therefore, be classified as a general principle of the European legal order, despite the fact that not all Member States might officially recognize its existence.¹¹⁴

A more stable foundation of the principle of ability to pay can be built considering such principle as a corollary of the equality principle in the field of taxation. Equality has been acknowledged as a general principle of EU law by the Court of Justice¹¹⁵ and is also recognized as a fundamental value of the Community in the Preamble of the Treaty of European Union. Furthermore, both art. 2 TEU and art. 20 of the Charter of Fundamental Rights¹¹⁶ also qualify equality as a fundamental value for the EU.¹¹⁷ Such a principle requires similar (comparable) situations to be treated the same way and different situation to be treated differently. Accordingly, as we have already noticed, ability to pay can be seen as a manifestation of the equality principle, both from an horizontal and a vertical prospective.

Furthermore, being the protection of taxpayer's minimum subsistence one of the aspects of the ability to pay theory, the connotation of such principle as "general" can be supported referring to the art. 2 and 3 of the Treaty of European Union, which identify human dignity (art. 2), social justice and solidarity (art. 3.3) as fundamental values for the European legal order. This view is confirmed also by the Preamble and by art. 34.3 of the Charter of Fundamental Rights.¹¹⁸

According to the Preamble of the Treaty of European Union and art. 151 TFEU, the Union and the Member States should pursue the fundamental social rights, as defined in the European Social Charter signed in Turin in 1961. Art. 16 of such Charter ensures the protection of family life through, *inter alia*, fiscal arrangements. Therefore, the grant of allowances to taxpayers for their dependent family members, constituting an aspect of the ability to pay concepts of taxation, can be considered a primary EU law requirement.¹¹⁹

Finally, art. 17 of the Charter of Fundamental Rights and art. 1 of Protocol No. 1 of the European Convention of Human Rights¹²⁰ protect, respectively, the right to property and the peaceful enjoyment of possession. Such norms seem to prohibit excessive taxation, which is, in essence, taxation that doesn't respect the ability to pay principle.

¹¹² AG Opinion in *Kefalas* (n. 75), para. 23.

¹¹³ See Case C-94/00, *Roquette Frères v Directeur général de la concurrence, de la consommation et de la répression des fraudes, and Commission of the European Communities*, 22 October 2002, EU:C:2002:603, para. 23.

¹¹⁴ This is what happened, for instance, regarding the principle of proportionality.

¹¹⁵ See, for instance, Case C-313/04, *Franz Egenberger GmbH Molkerei und Trockenwerk*, 11 July 2006, EU:C:2006:454, para. 33 and Case C-127/07, *Société Arcelor Atlantique et Lorraine and Others v Premier ministre, Ministre de l'Écologie et du Développement durable and Ministre de l'Économie, des Finances et de l'Industrie*, 16 December 2008, EU:C:2008:728, para. 23.

¹¹⁶ According to art. 6.1 TEU the Charter of Fundamental Rights has the same binding force of the Treaties.

¹¹⁷ Englisch (n. 104).

¹¹⁸ Ibid.

¹¹⁹ Ibid.

¹²⁰ According to art. 6.3 TEU the fundamental rights guaranteed by such Convention constitute general principles of EU law.

3. The ability to pay principle in the case law of the Court of Justice relating to tax benefits based on personal and family circumstances

3.1 Schumacker¹²¹

Mr Schumacker was a resident of Belgium but worked in Germany, where his employment income was taxable according to a treaty between the two countries. The same treaty required exemption with progression method to be applied to avoid double taxation. Even if Mr Schumacker was married to a woman that had no income of her own, he could not obtain the tax relief originating from the application of the German splitting tariff, since he was only subjected to limited liability in that country. Personal allowances and deductions were, indeed, only available to taxpayers resident in Germany.

The German Federal Finance Court asked the ECJ for a preliminary ruling, to find out if the national provisions were incompatible with the free movement of workers.

The European Judges highlighted that non-residents and residents are usually not in comparable situations and thus the fact that a Member State doesn't grant a tax benefit to non residents is not to be considered, as a rule, discriminatory.¹²² However, the ECJ pointed out that when a non resident receives the major part of his taxable income from the State of employment, and no significant income from the State of residence, the latter is not able to grant him (or her) tax benefits resulting from his/her personal and family circumstances.¹²³ Therefore, the fact that in a case like the one at issue, those circumstances were not taken into account in any of the two States involved, gave rise to a discrimination that constituted a breach of the free movement of workers.

The *Schumacker* case gave a new dimension to the comparability analysis and showed the capability of the ECJ to confront treaty provisions and EU law requirements in a very balanced position.¹²⁴ However, the "*Schumacker* system" rests on the wrong presupposition that income tax systems of EU countries are largely comparable,¹²⁵ whereas not all Member States' legislations contain provisions aimed at adjusting tax burdens by reason of personal and family circumstances.¹²⁶ Let's imagine a situation where the source State has a tax system with very high rates, while the residence State adopts a flat tax with a low rate but an extremely broad base.¹²⁷ While in the former all kind of personal deductions are granted to taxpayers, in the latter they have been politically swapped for a low rate, in which they are considered to be included.¹²⁸ In such a situation, according to the *Schumacker* doctrine, a person earning all his income in the host State doesn't suffer any discrimination, because the personal and family circumstances are taken

¹²¹ Case C-279/93, *Finanzamt Koeln-Altstadt v Roland Schumacker*, 14 February 1995, EU:C:1995:31.

¹²² *Ibid* para. 34.

¹²³ *Ibid* para. 38.

¹²⁴ Gracia Prats F.A., 'Revisiting "Schumacker": Source, Residence and Citizenship in the ECJ Case Law on Direct Taxation', in Richelle I., Schoen W. and Traversa E., *Allocating Taxing Powers within the European Union*, Springer, 2013, p. 2.

¹²⁵ Wattel P.J., 'Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Asscher, Gilly and Geschwind Do Not Suffice', in *European Taxation*, vol. 40, n. 6, 2000, p. 217.

¹²⁶ Mattsson N., 'Does the European Court of Justice Understand the Policy behind Tax Benefits Based on Personal and Family Circumstances?', in *European Taxation*, vol. 43, n. 6, 2003, p. 188.

¹²⁷ Wattel (n. 125), p. 216.

¹²⁸ *Ibid*.

into account by the home State the same way as those of all its residents.¹²⁹ There is no discrimination, since the taxpayer didn't lose any personal deduction by exercising his freedom of movement, simply because he didn't have any at home anyway.¹³⁰ Accordingly, following the reasoning of the Court in *Schumacker*, the source State is not obliged to do anything.¹³¹ However, the taxpayer would end up being taxed at the high rate of the host State, without receiving the connected personal allowances and deductions, which were, at home, somehow "included" in the low tax rates.¹³² Such outcome constitutes an evident drawback for persons considering to work in another Member State.¹³³

Thus, in conclusion, it can be stated that the *Schumacker* doctrine, according to which a taxpayer deriving substantially all his income in a country other than his State of residence should be allowed to have his personal and family circumstances taken into account in the country of employment, it's in line with the ability to pay principle as we have defined it in the previous chapter of this work. However, the problematic situation described above shows the difficulty to extend the findings of the Court in *Schumacker* to other cases.¹³⁴

3.2 Gilly¹³⁵

Mr and Mrs Gilly were both teachers and France residents. While Mr Gilly had French nationality and worked in France, Mrs Gilly was German and worked in Germany. However, she also acquired French nationality by marriage. According to the tax treaty between France and Germany, her employment income was taxed in Germany and France granted an ordinary tax credit, allowing her to set off against the tax due in France on her household income an amount equal to the fraction of French tax corresponding to the income earned in Germany. However, due to the greater progressivity of the German tax scale and to the fact that personal and family circumstances were taken into account in France and not in Germany, the tax credit granted to Mrs Gilly turned out to be less than the tax she actually paid in the employment State. For this reason the couple brought proceedings against the Administrative Court of Strasbourg, arguing that the application of the abovementioned provisions of the treaty at issue, allowing a degree of double taxation to remain, led to discriminatory and excessive taxation which was incompatible with EU law.

The case was referred to the ECJ for a preliminary ruling. The European Judges were asked, *inter alia*, if a tax credit mechanism, according to which nationals of a Member State who are frontier workers in another Member State are taxed more heavily than persons whose occupational activity is pursued in their State of residence, was contrary to the free movement of workers.¹³⁶ The Court of Justice gave a negative answer to this question.

First, the ECJ observed that the aim of tax treaties is simply to prevent the same income from being taxed twice, and not to ensure that the burden to which the taxpayer is subject in one State

¹²⁹Ibid.

¹³⁰ Ibid.

¹³¹ Ibid.

¹³² Ibid.

¹³³ Ibid.

¹³⁴ Mattsson (n. 126), p. 188.

¹³⁵Case C-336/96, *Gilly v Directeur des services fiscaux du Bas-Rhin*, 12 May 1998, EU:C:1998:221.

¹³⁶ Ibid para. 13(6).

is not higher than that to which he/she would be subject in another.¹³⁷ Moreover, the European Judges pointed out that the negative consequences of the tax credit method at issue were the result of the differences between the tax scales of the countries involved and that, in the absence of any Community legislation in the field, the determination of those scales was a matter for the Member States.¹³⁸

As regards the personal and family circumstances, which constitute the focus of our analysis, the ECJ held that the fact that those were taken into account in the State of residence and not in the State of employment was in line with the *Schumacker* doctrine. Indeed, France was in a better position to assess the personal situation of Mrs Gilly and, accordingly, granted her the related tax rebates and deductions.¹³⁹ Thus, German tax authorities were not obliged to take Mrs Gilly's personal and family circumstances into consideration.¹⁴⁰

However, if we investigate the way the French tax system works, it is doubtful that the ECJ decision can be considered in line with the ability to pay principle. Indeed, such system adds the incomes of husband and wife, halves the result, calculates the tax on that amount and finally doubles it.¹⁴¹ Afterwards, the tax corresponding to the proportion of Mrs Gilly's German income to the joint income is exempt.¹⁴² As the AG points out in his opinion, in France, when calculating tax benefits for family commitments, account is taken of the income taxable in that State.¹⁴³ Therefore, since Mrs Gilly's income was approximately 55% of the couple's total income,¹⁴⁴ it can be stated that, due to the French relief system,¹⁴⁵ she enjoyed only 45% of her allowances (and she wouldn't have enjoyed any if her husband had not had any income or if in France there had been a regime of separate taxation for spouses).¹⁴⁶ At the same time, Germany, the host State, didn't recognize a proportionate part of her personal allowances.

Moreover, as Wattel demonstrates, the disadvantages suffered by the Gillys were not the result of disparities between the systems of the Member States involved. Indeed, even if their tax systems were fully harmonized, only the disadvantage due to the greater progressivity of the German tax would have disappeared. On the contrary, the one related to the fact that personal and family circumstances of Mrs Gilly were not taken into consideration in France would have not been eliminated.¹⁴⁷

3.3 Gschwind¹⁴⁸

Mr Gschwind and his wife were Dutch nationals, living together in the Netherlands. In 1991 and 1992, however, Mr Gschwind was employed in Germany, crossing the border between the two

¹³⁷ Ibid para. 46.

¹³⁸ Ibid para. 47.

¹³⁹ Ibid para. 50.

¹⁴⁰ Ibid.

¹⁴¹ Artt. 194-195 *Code général des impôts*.

¹⁴² Avery Jones J.F., 'What is the Difference between Schumacker and Gilly?', in *European Taxation*, vol. 39, n. 1, 1999, p. 3.

¹⁴³ AG Opinion in *Gilly* (n. 135), para. 20.

¹⁴⁴ Ibid.

¹⁴⁵ Such system, indeed, allocated 55% of the personal expenses to the income taxed in Germany. See Wattel (n. 125), p. 221.

¹⁴⁶ Avery Jones (n. 142), p. 3.

¹⁴⁷ Wattel (n. 125), p. 220.

¹⁴⁸ Case C-391/97, *Frans Gschwind v Finanzamt Aachen-Aussenstadt*, 14 September 1999, EU:C:1999:409.

countries every working day and, according to the treaty between Germany and the Netherlands, his employment income was taxed in the source State. His wife, on the contrary, was employed and taxed in the Netherlands.

In 1995, as a consequence of the *Schumacker* decision, German law was changed (with retrospective effect) to allow married non-resident taxpayers, nationals of one of the EU Member States or of a State in the European Economic Area, regardless of their nationality, to apply for joint taxation under the splitting procedure in Germany, if his/her spouse was residing in one of those countries and i) at least 90% of the total income of the couple was subject of German income tax or ii) the income received abroad did not exceed DEM 24,000.¹⁴⁹ The Gschwinds didn't fulfill those requirements and the result was that, according to German law, Mr Gschwind was subject to unlimited tax liability in that country but treated as a single person.¹⁵⁰ He was therefore entitled to deductions accorded to residents to take account of their personal and family circumstances, but wasn't entitled to joint taxation.¹⁵¹ On the other hand, according to the Dutch legislation, Mrs Gschwind, being the spouse with the higher income (since her husband didn't have any taxable income in the Netherlands), enjoyed there the right to make deductions by reason of marriage.¹⁵²

Mr Gschwind appealed the decision of the German tax authorities and claimed to benefit from the splitting tariff,¹⁵³ arguing that the conditions laid down by German law were incompatible with the free movement of workers. Tax authorities, on the other hand, maintained that, according to the *Schumacker* doctrine, non residents should be allowed to benefit from the splitting tariff only if their personal and family circumstances couldn't be taken into consideration in the State of residence.¹⁵⁴ According to them, this wasn't the case in the situation at issue, since a significant part of the couple's revenue was gained in the home State.¹⁵⁵ The Court referred the case to the ECJ for a preliminary ruling.

The European Judges concluded the situation at issue was different from the one in *Schumacker*. Indeed, since almost 42% of the total income of the Gschwinds arose in their State of residence, that State was in a position to take into account Mr Gschwind's personal and family circumstances according to the rules laid down by its legislation, because the tax base there was sufficient for this purpose.¹⁵⁶ Therefore, the Gschwinds could not be considered in a situation comparable to that of a resident married couple¹⁵⁷ and, accordingly, the national legislation at issue didn't breach the free movement of workers and could not be declared discriminatory.

This ruling confirms that, from the point of view of the ability to pay, what matters to the ECJ is that personal and family circumstances are taken into account once somewhere. In the case at issue, those circumstances were taken into consideration partially in the Netherlands (through the

¹⁴⁹ Ibid para. 6.

¹⁵⁰ Ibid para. 11.

¹⁵¹ Ibid para. 7.

¹⁵² AG Opinion in *Gschwind* (n. 148), para. 17.

¹⁵³ Unless the spouses' incomes are equal, and thanks to an attenuation of the progressive nature of the income tax scale, the splitting tariff grants couples a tax relief, lowering the burden that would have been assessed if husband and wife were taxed separately. See *Gschwind* (n. 148), para. 4.

¹⁵⁴ *Gschwind* (n. 148), para. 15.

¹⁵⁵ Ibid para. 16.

¹⁵⁶ Ibid para. 29.

¹⁵⁷ Ibid para. 30.

marriage-related allowances granted to Mrs Gschwind) and partially in Germany (by granting Mr Gschwind the deductions accorded to resident single persons).¹⁵⁸ The fact of the marriage, in particular, was therefore reflected by way of tax reliefs in the residence State.¹⁵⁹ Allowing joint taxation of non-resident spouses without considering the amount of income received in the home State would determine taxpayer's personal situation to be taken into account twice, both in the Netherlands and in Germany. In particular, as the AG points out in his opinion, "*Mr Gschwind would be liable to a lower rate of tax if his wife's income had to be taken into account and if two deductions, instead of one, were made on the whole of the income, while his wife would not be subject to a higher tax rate because the income of the two spouses would not be aggregated in the Netherlands, Mrs Gschwind being taxed on an individual basis*".¹⁶⁰

Another perspective on this judgment, however, can be assumed if focusing on Mr Gschwind's individual income, instead of the family income of the couple.¹⁶¹ From this point of view, the outcome of the case seems unsatisfactory as regards the respect of the ability to pay principle. Indeed, even if Mr Gschwind only asked to be granted the splitting regime, and therefore the ECJ didn't tackle the matter, it can be observed that part of his personal allowances went lost in exercising his freedom of movement within the EU, due to the double taxation relief method that provides for exemption in the residence State of the income earned abroad.¹⁶² The functioning of such mechanism will be clarified in detailed further on, when analyzing *de Groot* case but it can be here anticipated that, as Wattel points out, the final result of such relief method was that Mr Gschwind effectively lost his Netherlands personal allowances.¹⁶³

In *Gschwind* the ECJ seemed to assume that every time the income earned in the residence State is higher than the deductions related to personal and family circumstances available in that State, the taxpayer will always be able to fully enjoy his/her personal deductions there.¹⁶⁴ However, as the analysis of next cases will reveal, such assumption might turn out to be incorrect if the residence State, in order to calculate the double taxation relief, multiplies the tax on total income by the so called "proportionality factor" (a fraction having foreign gross income as numerator and total gross income as denominator).¹⁶⁵

Finally, it's important to underline that, by approving the 90% threshold provided for by German law in order to qualify for the splitting regime, the European Judges have implicitly approved the same threshold also for the grant of other tax benefits related to personal and family circumstances.

¹⁵⁸ Newey R., 'Gschwind Decision German Tax Law Not Discriminatory for Non-Resident Married Couples', in *European Taxation*, vol. 40, n. 3, 2000, p.117.

¹⁵⁹ Ibid.

¹⁶⁰ AG Opinion in *Gschwind* (n. 148), para. 46.

¹⁶¹ Wattel (n. 125), p. 218.

¹⁶² De Broe L. and Gernay T., 'Belgium: the Imfeld & Garcet case and the Levy case', 2012, p. 16, available at http://www.lindeverlag.at/titel-55-55/ecj_recent_developments_in_direct_taxation_2012-5260/titel/leseprobe/9783707322903.pdf (accessed 5 April 2014).

¹⁶³ Wattel (n. 125), p. 218.

¹⁶⁴ Ibid, p. 217.

¹⁶⁵ Ibid, p. 218.

3.4 Zurstrassen¹⁶⁶

Mr Zurstrassen and his wife were Belgian nationals. Mr Zurstrassen worked in Luxembourg, where he was regarded as a resident for tax purposes. However, he was coming home to Belgium in the weekends to spend time with his wife and children. Mr Zurstrassen's employment income constituted 98% of the income of the household, while his wife didn't earn any income of her own.

For the years 1995 and 1996, the Luxembourg tax authorities placed Mr Zurstrassen in tax bracket 1, which was the one applicable to single persons because, according to the domestic law of that country, joint assessment was only possible if both spouses were resident in Luxembourg. Mr Zurstrassen, however, claimed to be included in bracket 2 because he wished to enjoy the more favorable taxation regime recognized by Luxembourg law to married couples. In particular, he argued that the contested decisions were discriminatory because he and his wife were placed at a disadvantage, first, compared with spouses residing in Luxembourg (that were assessed jointly), and second, compared with married non residents where they earned more than a half of their household income in Luxembourg, because in that case they were also eligible for joint taxation.¹⁶⁷ The Luxembourg Administrative Court asked for a preliminary ruling to the ECJ, which decided the case on the basis of the free movement of workers.

The European Judges concluded that EU law precluded a legislation like the one at issue. It's interesting to notice that (indirect) discrimination was based, in the present case, not on taxpayer's residence but on his wife's.¹⁶⁸ This outcome was in line with the previous case law and seems to confirm the principle according to which personal and family circumstances should be taken into account once somewhere. As the AG points out in his opinion, the situation at issue was different from those of the *Schumacker*, *Gilly* and *Gschwind* cases because Mr Zurstrassen was resident in the State where his employment income was taxable.¹⁶⁹ Furthermore, since his wife had no income of her own, all the income of the couple was earned in Luxembourg.¹⁷⁰ Thus, that State taxed Mr Zurstrassen's worldwide income and, in accordance with the rules of international tax law, was responsible of taking into account his personal and family circumstances.¹⁷¹

3.5 De Groot¹⁷²

Mr de Groot was resident in the Netherlands and, in 1994, he had derived employment income from the Netherlands and also from France, Germany and the United Kingdom. According to tax treaties, employment income he earned in these three Member States was exempt in the Netherlands, but taken into account there for determining progressivity of tax rates (exemption with progression). As a result of this mechanism, Mr de Groot could not deduct alimony payments to his ex wife in any of the source States and, at the same time, in the Netherlands he could only enjoy a relief equal to 40% of the amount of those payments.¹⁷³ Indeed, in order to

¹⁶⁶ Case C-87/99, *Patrick Zurstrassen v Administration des Contributions Directes*, 16 May 2000, EU:C:2000:251.

¹⁶⁷ *Ibid* para. 12.

¹⁶⁸ Newey R., 'Discrimination against Resident whose Spouse Lived in Another Member State', in *European Taxation*, vol. 40, n. 12, 2000, p. 556.

¹⁶⁹ AG Opinion in *Zurstrassen* (n. 166), para. 37.

¹⁷⁰ *Zurstrassen* (n. 166), para. 22.

¹⁷¹ AG Opinion in *Zurstrassen* (n. 166), para. 37.

¹⁷² Case C-385/00, *F.W.L. de Groot v Staatssecretaris van Financien*, 12 December 2002, EU:C:2002:750.

¹⁷³ *Ibid* para. 37.

avoid double taxation, the Netherlands granted Mr de Groot a reduction on his worldwide income, calculated according to this formula:

$$\frac{\text{foreign gross income}}{\text{total gross income}} * \text{tax on worldwide income.}^{174}$$

Accordingly, personal allowances were taken into consideration in the computation of the worldwide tax liability, but were disregarded when calculating the proportion of foreign income, being therefore allocated to gross domestic income and gross foreign income on a pro rata basis.¹⁷⁵ This means that those allowances were deducted from the tax payable in the Netherlands only in proportion to the income received by the taxpayer in that State.¹⁷⁶

Mr de Groot complained that the above illustrated provisions of national law put him in a worse situation than that of Dutch residents only working in the Netherlands. He argued that such situation constituted a breach of the free movement of workers. The Supreme Court of the Netherlands submitted the case to the ECJ for a preliminary ruling on the matter.

The Court of Justice recognized that the provisions at issue had the effect of dissuading an individual resident in the Netherlands from taking up work in other Member States and were therefore discriminatory because not granting a greater relief. The European Judges pointed out, in contrast to what the Netherlands Government had argued, that the case at issue had to be distinguished from *Gilly*, since Mr de Groot's disadvantage could not be attributed to the differences between the tax systems of the two countries involved.¹⁷⁷ Moreover, unlike Mr de Groot, Mrs Gilly obtained in her home State all the tax advantages recognized to its residents by the legislation of that State.¹⁷⁸ The European Judges also underlined that Germany, France and the United Kingdom had no obligation to take into account Mr de Groot personal and family circumstances because, according to *Schumacker* and *Gschwind*, the source State is required to do so only where the taxpayer derives all or almost all of his taxable income from employment in that State, without having any significant income in his State of residence.¹⁷⁹

The national Court also asked the ECJ whether EU law lays down specific requirements regarding the way the State of residence must take into consideration personal and family circumstances of an individual who has worked in another Member State. The European Judges answered that there were no specific requirements, a part from the respect of the non-discrimination principle.¹⁸⁰

It is worthwhile noticing the ECJ identified the unfavourable treatment of Mr de Groot by comparing his situation to that of sedentary workers receiving the same earnings.¹⁸¹ However, even if Mr de Groot lost part of his personal tax reliefs, he was also exempt from tax in the Netherlands in proportion to the ratio between his foreign income and his worldwide income.¹⁸²

¹⁷⁴ AG Opinion in *de Groot* (n. 172), para. 9.

¹⁷⁵ Valat A., 'General Allowances and Home-State Obligations under EC Law: Opinion Delivered in the De Groot Case', in *European Taxation*, vol. 42, n. 10, 2002, p. 447.

¹⁷⁶ AG Opinion in *de Groot* (n. 172), para. 10.

¹⁷⁷ *De Groot* (n. 172), para. 85.

¹⁷⁸ *Ibid* para. 87.

¹⁷⁹ *Ibid* para. 89.

¹⁸⁰ *Ibid* para. 115.

¹⁸¹ *Ibid* para. 94.

¹⁸² Valat (n. 175), p. 449.

Moreover, none of the three source States took into account income earned outside its borders, with a consequent significant progression benefit for the taxpayer.¹⁸³ Thus, the overall fiscal burden might have been even higher for individuals only working in the Netherlands than for those who derived part of their earnings in other Member States.¹⁸⁴ The judgment at issue could therefore be criticized from this point of view and, for what concerns the ability to pay principle, such observation is helpful to acknowledge the wide scope of that concept. It is difficult to assess the conformity of a national measure to that principle limiting the analysis only to one expression of the ability to pay, like the personal and family situation of the taxpayer. Ability to pay in an all-embracing concept, determined by the combined elements of all tax systems of the countries in which taxpayer's income is sourced,¹⁸⁵ and therefore all its aspects should be considered in order to avoid the risk of double dips.

3.6 Wallentin¹⁸⁶

Mr Wallentin resided in Germany, where he was a student. He received a monthly grant from the German State, along with a sum of money that his parents paid to him every month. According to German law, such payments were not taxable. During the summer of 1996, Mr Wallentin worked in Sweden as an intern for the Church of Sweden, and from such employment he received remuneration. According to Swedish law, individuals residing in Sweden for more than six months were granted a monthly ground allowance in proportion to the number of months of residence, while non-resident taxpayers staying in Sweden for a shorter period were subjected to a 25% withholding tax on the income earned in that country and could not benefit of any ground allowance. Accordingly, since Mr Wallentin was resident in Germany, the Swedish tax authorities refused to grant him the ground allowance and taxed the remuneration he received from the Swedish Church with a withholding tax of 25%. However, the tax rate for residents was higher than that for non residents, since the former were taxed with a progressive rate averaged at 30%.

The ECJ was asked if the tax regime for non residents described above could be considered incompatible with the free movement of workers. The European Judges referred to the *Schumacker* case and repeated that, when a non resident doesn't receive any significant income in his residence State and earns the major part of his taxable income from an activity performed in the State of employment, the home State can't grant him tax benefits relating to his personal and family circumstances.¹⁸⁷ Furthermore, the Court pointed out that German basic allowance reflected consideration of the taxpayer's personal and family situation, having the social purpose of ensuring that he/she has a minimum subsistence amount not subject to income tax.¹⁸⁸ The same observation is to be considered valid, according to the ECJ, in respect of the basic allowance provided for by Swedish tax law.¹⁸⁹ Therefore, in a case like the one at issue, according to the EU principle of equal treatment, the State of employment should take into consideration personal and family circumstances of a foreign non resident in the same way as those of resident

¹⁸³ Wattel (n. 125), p. 212.

¹⁸⁴ Valat (n. 175), p. 449.

¹⁸⁵ Vanistendael F., 'Ability to pay in European Community Law', in *EC Tax Review*, vol. 3, 2014, p. 134.

¹⁸⁶ Case C-169/03, *Florian W. Wallentin v. Riksskatteverket*, 1 July 2004, EU:C:2004:403.

¹⁸⁷ *Ibid* para. 17.

¹⁸⁸ *Ibid* para. 19.

¹⁸⁹ *Ibid*.

nationals in a comparable situation (i.e. granting the same tax benefits).¹⁹⁰ The Court concluded that free movement of workers precluded a national legislation like the one at issue.¹⁹¹

Despite the reference of the ECJ to *Schumacker*, *Wallentin* presents important differences compared to the situation at issue in the former judgment and should not be seen as a mere repetition of it. Indeed, the situation of Mr Wallentin was far from being comparable to that of a resident of the State of employment, since the activity he was performing in Sweden took place for a limited period of time and was of an occasional nature, being exempt in Germany because of the nature of the income.¹⁹² The European Judges seem therefore to have broadened the scope of the *Schumacker* doctrine and to have used it to justify some kind of "subsidiarity principle", according to which the State of employment should grant personal allowances every time the residence State is not in the position of granting them.¹⁹³ This principle had been already followed in *de Groot*, where the Court held that the residence State may be released from its obligation to take into account in full the personal and family situation of the taxpayer if, even in the absence of a convention, one or more of the employment States grant advantages based on their personal situations to individuals who do not reside in the territory of those States but receive taxable income there.¹⁹⁴

It is worthwhile noticing that in *Wallentin* the European Court of Justice ruled Swedish law constituted a breach of the free movement of workers, despite the fact that non residents were taxed at a flat and lower tax rate compared to residents. This observation highlights, once again, that the ECJ seems to accept possible double dip situations. Indeed, Mr Wallentin ended up enjoying both basic allowance and low tax rates in Sweden.¹⁹⁵

3.7 Meindl¹⁹⁶

Mr Meindl was an Austrian national resident in Germany, where he received employment income from professional and artisanal activities, while his wife, Mrs Meindl-Berger, was an Austrian national residing in Austria. In 1997 Mrs Meindl-Berger gave birth to a child and she received therefore a confinement allowance, a special maternity allowance and a family allowance from the Austrian State, all exempt from tax according to Austrian law. In 1997 the Meindls applied for joint assessment in Germany but their application was refused by tax authorities, which on the contrary decided that Mr Meindl should have been taxed as an unmarried person. Indeed, according to the German law, joint assessment and splitting regime for non permanently separated married couples with one partner residing abroad could only be granted when at least 90% of the income of both spouses' worldwide income was subject to German income tax, or when the amount not subject to the latter did not exceed a certain threshold. The Meindls' total income received in Germany was less than 90% and the income not subjected to German tax exceeded the allowed threshold because, even if Mrs Meindl-Berger confinement and maternity

¹⁹⁰ Ibid para. 21.

¹⁹¹ Ibid para. 24.

¹⁹² Bardini C., "The ability to Pay in the European Market: An Impossible Sudoku for the ECJ", in *Intertax*, vol. 38, n. 1, 2010, p. 5.

¹⁹³ Ibid.

¹⁹⁴ *De Groot* (n. 172), para. 100.

¹⁹⁵ However, it should be mentioned that, since Mr Wallentin earned 8 724 sek in Sweden and the basic allowance there covered 8 600 sek, he did not actually enjoy a significant benefit from the low tax rate.

¹⁹⁶ Case C-329/05, *Finanzamt Dinslaken v Gerold Meindl*, 25 January 2007, EU:C:2007:57.

allowances were exempt in Austria, those benefits were not paid under German law and therefore had to be taken into consideration in that calculation.

The case was referred to the ECJ for a preliminary ruling. In particular, the Bundesfinanzhof asked if the refusal to joint assessment in a situation like the one at issue had to be considered contrary to the freedom of establishment. The European Judges pointed out that Mr Meindl situation was comparable to that of residents taxpayers whose spouses, receiving only exempt income, are also resident in Germany, because in both cases the taxable income of the couple derives from the activity of one of the spouses, which is resident in that Member State.¹⁹⁷ Accordingly, the Treaty was held to preclude rules like the ones at issue.¹⁹⁸ Like in *Zurstrassen*, discrimination was based not on taxpayer's residence but on his wife's. The Court referred to *Zurstrassen* underlining that in situations like the one of the Meindls the residence State is the only one that can take into consideration taxpayers personal and family circumstances, since the entire taxable income of the household is received there.¹⁹⁹ The ECJ also pointed out the difference between the case at issue and *Gschwind*, a "source State case", where a legislation like the one at issue was declared compatible with the Treaty because the possibility to take taxpayers' personal circumstances into account was maintained in their country of residence.²⁰⁰

As regards what rules need to be taken into consideration to measure the taxpayer's ability to pay, the ECJ seems therefore to dictate in this case a sort of mutual recognition rule, according to which the employment State can't take into account income of one of the spouses which is not taxable in his or her residence State.²⁰¹ As the AG underlined referring to *Wallentin* case, income exempt from taxation in Austria could not constitute significant income²⁰² in Germany and, accordingly, it should have not been taken into account by the latter State when assessing the respect of the threshold provided for to obtain joint assessment.

3.8 Beker²⁰³

Mr and Mrs Beker were residents in Germany and there jointly assessed for income tax purposes. In 2007, along with their German income, they received also income from dividends deriving from capital holdings in some companies having their principal place of business in France, Luxembourg, the Netherlands and in some third States. According to the treaties between Germany and the countries of origin of those dividends, the former, being the State of residence, was allowed to tax the Bekers' worldwide income, including the foreign dividends at issue. However, to avoid double taxation, withholding tax paid abroad on the dividends was offset against the income tax due in Germany, up to the level of the tax charged on the income concerned in that country. Moreover, German law stated a limit to the amount of foreign withholding tax which could be offset against income tax due in Germany. Such limit was calculated by the tax authorities following this formula:

¹⁹⁷ Ibid para. 26.

¹⁹⁸ Ibid para. 32.

¹⁹⁹ Ibid para. 29.

²⁰⁰ Ibid para. 31.

²⁰¹ Gracia Prats (n. 124), p. 19.

²⁰² AG Opinion in *Meindl* (n. 196), para. 42.

²⁰³ Case C-168/11, *Dr Manfred Beker and Christa Beker v Finanzamt Heilbronn*, 28 February 2013, EU:C:2013:117.

*income tax due according to the income tax scale*²⁰⁴ * $\frac{\text{foreign income}}{\text{total income}}$. Since the total income was calculated without taking into account special expenditures and extraordinary costs like those related to personal and family circumstances, while they were taken into consideration when determining the income tax due according to the income tax scale, Mr and Mrs Beker contested the fiscal assessment. The Bundesfinanzhof, doubting about the compatibility of such method of calculation of the maximum amount deductible with the free movement of capital, decided to submit the ECJ a question for a preliminary ruling.

The European Judges underlined that the effect of the contested rules was to allow resident taxpayers to benefit completely from personal and family allowances when they receive all their income in Germany, while, if they received part of their income abroad, they could benefit from such tax benefits only up to the amount of income received in the residence State.²⁰⁵ Furthermore, the proportion of those allowances not taken into account in Germany was not taken into account in the source States either, because, according to the Court, they are required to do so only where the taxpayer receives almost all or all of his taxable income there, without having any significant income in his home State.²⁰⁶ Thus, according to the ECJ, resident taxpayers who had earned part of their income abroad were in a worse situation compared to individuals residing in the same State and deriving all their income in the home State.²⁰⁷ For those reasons the ECJ stated that the contested rules, discouraging residents from investing their capital in companies having their principal place of business in other Member States or in third countries, were incompatible with the Treaty.²⁰⁸

The outcome of the case seems to be in line with the ability to pay principle and with the doctrine according to which all taxpayers' personal and family circumstances should be taken into account once somewhere. It's worthwhile noticing that such outcome wasn't precluded by the fact that German law provided for the possibility of choosing a system other than the one at issue, i.e. the deduction of foreign taxation from the taxable amount.²⁰⁹ Indeed, according to the ECJ, the existence of an option which would render a situation compatible with EU law does not neutralize the illegal nature of a system.²¹⁰

3.9 Imfeld and Garcet²¹¹

Mr Imfeld was a German national residing in Belgium with his Belgian wife, Mrs Garcet, and their two children. Mrs Garcet earned some income from an employment activity in Belgium, while her husband derived all his income, constituting more than a half of the couple's total income, working as a lawyer in a German office. According to the treaty between Germany and Belgium, income generated by a Belgian resident from self-employed professional activities was taxable only in the residence State, unless the taxpayer had a fixed base for the exercise of his activities in the source State. In that case, the income attributable to the activities carried out

²⁰⁴ Such amount corresponds to the tax that would have been paid by the taxpayer if all his revenues had been obtained in Germany (ibid para. 37).

²⁰⁵ *Beker* (n. 203), paras. 40 and 41.

²⁰⁶ Ibid para. 44.

²⁰⁷ Ibid para. 51.

²⁰⁸ Ibid paras. 52 and 53.

²⁰⁹ Ibid para. 61.

²¹⁰ Ibid para. 62.

²¹¹ Case C-303/12, *Guido Imfeld and Nathalie Garcet v Belgian State*, 12 December 2013, EU:C:2013:822.

through the fixed base should have been taxed in the source State and Belgium should have exempted such amounts, however taking them into consideration for the purpose of determining tax rates (exemption with progression). Belgian law provided that the tax had to be calculated reducing the worldwide income of the taxpayer according to the proportion of the overall income represented by the exempted income. In addition to this reduction, a Circular adopted by Belgian State in 2008 (to comply with the *de Groot* doctrine) provided for a supplementary tax relief for income earned abroad and exempt under international Conventions if i) the personal and family circumstances of the taxpayer were not taken into consideration for calculating the tax due in the source State, ii) the taxpayer wasn't able, in Belgium, to qualify in full for the tax advantages related to his personal or family situation and iii) the tax due in Belgium, together with the tax due abroad, was higher than the tax which would have been due if the income had been entirely earned in Belgium. Moreover, each taxpayer was granted a tax-free allowance, increasing if that person had dependants. In case of joint return, required by Belgian law for married couples,²¹² such increase was set off against the income of the spouse with the highest income.²¹³

According to the double taxation treaty, Mr Imfeld was subject to tax in Germany, where he was treated as a single person, without therefore having the possibility of enjoying the fiscal advantages of the splitting regime.²¹⁴ Nevertheless, he enjoyed there an allowance for his dependent children. On the other hand, in Belgium, his German income was exempted with progression and, being the spouse with the higher income, he was granted a children allowance also in that State. However, since Mr Imfeld didn't earn any taxable income in Belgium, such tax relief didn't constitute a real advantage for him. At the same time, Mr Imfeld could not enjoy the relief provided for from the Circular of 2008 because his personal and family circumstances were taken into account in the source State. For those reasons, Mr Imfeld and Mrs Garcet filed two separate tax returns and only the latter claimed the allowance for dependent children. The Belgian tax authorities, however, issued a correction notice, stating that the couple would be taxed jointly, on basis of a new taxable amount.

The case was referred to the ECJ for a preliminary ruling. In particular, the Belgian Court asked if a national legislation like the one had issue in the main proceedings was compatible with EU law, to the extent it had the effect that a couple in a situation like the one of Mr Imfeld and Mrs Garcet, where one of the members of the couple was taxed separately on his earned income and couldn't obtain all of the tax advantages relating to his personal and family circumstances, didn't receive a specific tax advantage, even though that couple would have been entitled to it if both partners had earned all or most of their income in the residence State.²¹⁵ According to the European Judges, the freedom of establishment precluded such legislation.

The ECJ pointed out that, even if personal and family circumstances were taken into account, at least in part, in both Germany and Belgium, the combined application of the system of exemption subject to progressivity and the rules for offsetting the supplementary allowance for

²¹² The tax due from each of the spouses is, however, determined separately on the income of each of them. See AG Opinion in *Imfeld & Garcet* (ibid), para. 49.

²¹³ See AG Opinion in *Imfeld & Garcet* (n. 210), paras. 40, 41 and 42.

²¹⁴ Because Mr Imfeld's taxable income in Germany was less than 90% of the total income of his household and his wife's income was higher than both the absolute threshold of EUR 12 372 and the relative threshold of 10% of overall income laid down by German law. See AG Opinion in *Imfeld & Garcet* (n. 211) para. 26.

²¹⁵ *Imfeld & Garcet* (n. 211), para. 40.

dependent children provided for by Belgian law, resulted in the impossibility for the couple to effectively enjoy the latter relief.²¹⁶ Thus, the applicants suffered, as a couple, a disadvantage that was likely to discourage the exercise of a freedom guaranteed by the Treaty.²¹⁷ The European Judges highlighted that such disadvantage could not be considered compensated by the grant of a tax advantage in Germany, i.e. by the fact that Mr Imfeld's personal situation was partially taken into consideration in that country.²¹⁸ The loss of the entire children allowance in Belgium was, according to the ECJ, contrary to the freedom of establishment, irrespectively of the tax treatment accorded to Mr Imfeld in the State of employment.²¹⁹ As in *de Groot*, the Court repeated mechanisms used to eliminate double taxation must guarantee the taxpayer the certainty that, at the end of the day, all his/her personal and family circumstances will be duly taken into account, irrespectively of how Member States have allocated obligations amongst themselves.²²⁰ Furthermore, the ECJ confirmed the "subsidiary principle", when it said, quoting *de Groot*, that residence States are released from the obligation to take into consideration personal situations of taxpayers if the connected tax benefits are already granted in the source State, even in the absence of an international agreement.²²¹

The European Judges, following the AG opinion, seemed to accept the possibility that, being tax advantages recognized by each of the two Member States concerned comparable, the applicants may receive a double relief:²²² once in the State of employment for the spouse who exercised his freedom of establishment and once in the State of residence for the partner who did not exercise any freedom.²²³ According to the judgment, such double advantage should be considered only the result of the simultaneous application of national tax legislations of the two countries involved.²²⁴ However, a similar duty for the residence State to carry-over the unused family allowances to the partner who didn't exercise its freedom seems to open the way to double dips and therefore to conflict with the ability to pay principle, according to which personal and family circumstances should be always taken into consideration somewhere, but only once.²²⁵

4. Final remarks

4.1 The limits of the negative integration of the Court of Justice

The judgments analyzed in the previous chapter show that the ECJ has been asked, in several occasions, to intervene in cases where the cross-border character of the situations involved constituted a risk for the principle of ability to pay. However, the solutions elaborated from the European Judges in those rulings, present some problematic aspects and can't be held fully in line with the ability to pay principle.

²¹⁶ Ibid paras. 47, 48 and 49.

²¹⁷ Ibid paras. 50 and 51.

²¹⁸ Ibid paras. 59 and 60.

²¹⁹ Ibid para. 62.

²²⁰ Ibid para. 70.

²²¹ Ibid para. 69.

²²² Ibid para. 78.

²²³ De Broe (n. 162), p. 15.

²²⁴ *Imfeld & Garvet* (n. 211), para. 78.

²²⁵ De Broe (n. 162), p. 15.

The answer provided by the ECJ in *Schumacker* allowed the taxpayer, in that specific case, to be taxed according to his ability to pay, being his personal and family circumstances fully taken into account once, in the source State. However, as already pointed out, this doctrine doesn't consider the consequences of the non-comparability of Member States' fiscal systems and doesn't always bring to positive results for taxpayers. Therefore, it cannot be automatically extended to all similar cases. Moreover, it's worthwhile noticing that, according to *Schumacker*, a discrimination occurs when an individual loses, for instance, 92% of his personal deductions, but not when he loses 88% of those.²²⁶ Such outcome can't be held satisfactory.

The weaknesses of the solution provided by the ECJ in *Schumacker*, according to which the home State is always responsible to grant tax reliefs connected to the personal situation of taxpayers, unless they derive all or almost all their income in the host State, clearly appeared in *Gilly*, when this reasoning turned out to be insufficient to ensure a correct application of the ability to pay principle. Indeed, as a consequence of that judgment, taxpayer's benefits for family commitments ended up being recognized in the home State, *de facto*, only partially.

Moreover, the *Schumacker* doctrine doesn't provide any help in situations where income of the taxpayer is earned in more than two countries or in just two countries but according to different percentages.²²⁷ In *Gschwind*²²⁸ the ECJ seemed to assume that, whenever income earned in the residence State is higher than deductions related to personal and family circumstances available in that country, taxpayers will always be able to fully enjoy their personal deductions there.²²⁹ Nevertheless, the cases analysis performed in the previous chapter revealed that such assumption might turn out to be wrong if the residence State, in order to calculate the double taxation relief, multiplies the tax on total income by the so called "proportionality factor".

However, it should be reminded that the application of the principles stated by the Court in *Schumacker* brought to satisfactory results from the point of view of the ability to pay principle in *Zurstrassen*, *Meindl* and *Beker*, without giving rise to particular problems.

De Groot judgment pointed out the most critical aspect of the activity of the ECJ regarding the protection of the ability to pay principle in cross-border situations: the risk of double dipping. Indeed, as highlighted when analyzing *Schumacker*, Member States can choose to replace personal tax benefits with lower rates or, on the contrary, to compensate benefits they grant with higher rates.²³⁰ If the employment State adopts a system like the former and the residence State is required to give personal deductions and allowances, a double dip situation arises.²³¹ Mr de Groot ended up being in a similar beneficial position thanks to the grant of personal allowances in the residence State (combined with the proportional exemption applied there) and, at the same time, to the progression benefit enjoyed in the host States.

²²⁶ Wattel P.J., 'Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Asscher, Gilly and Geschwind Do Not Suffice', in *European Taxation*, vol. 40, n. 6, 2000, p. 217.

²²⁷ Bardini C., 'The ability to Pay in the European Market: An Impossible Sudoku for the ECJ', in *Intertax*, vol. 38, n. 1, 2010, p. 5.

²²⁸ See, in particular, Case C-391/97, *Frans Gschwind v Finanzamt Aachen-Aussenstadt*, 14 September 1999, EU:C:1999:409, paras. 28 and 29.

²²⁹ Wattel (n. 226), p. 217.

²³⁰ *Ibid* p. 216.

²³¹ Bardini (n. 227), p. 10.

However, double dips can also take place within just one country jurisdiction, like in *Wallentin*. Indeed, in that case, the ECJ recognized a double benefit to the taxpayer in his State of employment, requiring the latter to grant him the basic allowance provided for residents and, at the same time, the lower tax rates enjoyed by non-residents.

Finally, the recent *Imfeld & Garvet* case constitutes another example of judgment in which the Court of Justice has allowed taxpayers to enjoy, as a couple, a double benefit. In particular, the effect of that ruling seems to be Mr Imfeld's personal and family circumstances being taken into account twice, through an allowance for dependent children in the State of residence and through all personal deductions recognized by the source State.

Ability to pay is a unitary concept, linked to the overall situation of the taxpayer.²³² For this reason, in order to achieve results consistent with that principle, a certain level of coordination between fiscal systems of Member States is required. The ECJ seems to have realized this necessity and, accordingly, in *de Groot*, *Wallentin* and *Imfeld & Garvet*, has been using an "overall approach".²³³ Thus, as we have seen, in those cases the *Schumacker* doctrine has been extended and transformed into a sort of "subsidiarity principle" to avoid disadvantages for taxpayers, basically requiring Member States to take into consideration their personal and family circumstances whenever they wouldn't otherwise be taken into account anywhere. Such approach implies, however, a risk that the solution achieved might be put out of balance by possible changes in one of the national legislations involved, or that a domestic rule might be held discriminatory and, at the same time, in line with EU law, depending on the rules of the other country it is combined with.²³⁴ Such events might constitute a threat for the principle of legal certainty. As pointed out above, however, the overall approach doesn't seem to be used by the Court when it comes to identifying and avoiding situations of double dipping.

4.2 The role of tax treaties and the possible solution provided by fractional taxation

As emerged from the analysis of the case law performed in the previous chapter, tax treaties play a very significant and critical role in the recognition of taxpayers' ability to pay in cross-border situations.

In *Gilly* the Court of Justice clearly stated that, in absence of harmonization, Member States are free to choose the method they prefer in order to avoid double taxation.²³⁵ According to the European Judges, the aim of tax treaties is simply to prevent the same income from being taxed twice, and not to ensure that the burden to which the taxpayer is subject in one State is not higher than that to which he/she would be subject in another.²³⁶ On the other hand, in *de Groot*, the ECJ held that double taxation relief methods "*must permit the taxpayers in the States concerned to be certain that, as the end result, all their personal and family circumstances will be duly taken into account*".²³⁷

As regards the grant of tax benefits relating to personal and family circumstances, the choice of the relief mechanism by the residence State is not particularly relevant in situations like the one at issue in the *Schumacker* ruling, i.e. when an individual derives all or almost all his income in the

²³² Ibid p. 9.

²³³ Such term is used as opposed to the "per-country approach". See *ibid*.

²³⁴ Bardini (n. 227), p. 9.

²³⁵ Case C-336/96, *Gilly v Directeur des services fiscaux du Bas-Rhin*, 12 May 1998, EU:C:1998:221, paras. 24 and 30.

²³⁶ Ibid para. 46.

²³⁷ Case C-385/00, *F.W.L. de Groot v Staatssecretaris van Financiën*, 12 December 2002, EU:C:2002:750, para. 101.

source State. Indeed, in case of exemption method, those benefits can't be enjoyed in the home State due to the lack of taxable base in that country, whereas, if a credit method is chosen, they will give rise to an excess of foreign tax credit (unless tax rates are much lower in the State of employment).²³⁸ Thus, in both those cases, the source State is the only one in the position to take into account taxpayers' personal and family circumstances and, accordingly, it will be requested to do so. However, as pointed out when analyzing the *Schumacker* case, due to the non-comparability of tax systems, such solution is not always satisfactory from the point of view of the ability to pay principle.

The situation is more complicated when the income is earned in two or more States. Indeed, when the residence State adopts a credit method, tax benefits relating to the personal situation of the taxpayer granted by the Source State may end up being washed out if the tax imposed by the home country is higher than that imposed by the employment State.²³⁹ On the other hand, if the residence State grants personal deductions and the source State doesn't, the taxpayer may suffer an excess of foreign tax credit if the tax paid in the latter State turns out to be higher than the one paid in the home country.²⁴⁰

However, not even the exemption method seems to be a possible solution for building a taxation mechanism ensuring family and personal circumstances of the taxpayer to be duly taken into account in cross-border situations. Indeed, when applying such method, residence States refrain from levying the portion of domestic tax attributable to the income earned abroad.²⁴¹ As we have seen analyzing *de Groot*, such portion is calculated through a formula causing a loss of the benefits deriving from personal deductions and allowances, which is proportional to the foreign part of the taxpayer's income.²⁴²

The OECD Model doesn't seem to consider the above mentioned problems that the allocation of taxing powers between States might determine with respect to the ability to pay principle. A justification to this silence, however, can be found in the Commentary on art. 23A and 23B, where it's stated that the amount to be exempted from tax varies greatly from country to country, depending on their tax structure and policy considerations. As pointed out by the Commentary itself, this is particularly true when it comes to determining how and to what extent tax benefits related to personal and family circumstances should be granted to taxpayers.²⁴³ Accordingly, the OECD Model doesn't provide an uniform solution for the determination of tax (especially allowances, deductions and similar benefits), but leaves each country free to adopt its own legislation and technique and, eventually, to solve particular problems through bilateral negotiations.²⁴⁴ Similar considerations are made with regard to the credit method.²⁴⁵

A theoretical solution to the highlighted problems and to the possible double-dip situations identified in the previous paragraph has been proposed by Wattel and consists in the so called

²³⁸ Bardini (n. 227), p. 7.

²³⁹ Ibid.

²⁴⁰ Ibid.

²⁴¹ Ibid p. 8.

²⁴² However, as pointed out by Wattel, the same mechanism is usually adopted also by credit countries (see Avery J., 'A Comment on "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances"', in *European Taxation*, vol. 40, n. 8, 2000, p. 377).

²⁴³ Para. 42 Commentary to art. 23A OECD Model.

²⁴⁴ Para. 43 Commentary to art. 23A OECD Model.

²⁴⁵ Para. 62 Commentary to art. 23B OECD Model.

"fractional taxation".²⁴⁶ According to this approach, Member States should apply the relief method they prefer, whether credit or exemption, not just to residents but also to non residents, even if only with regard to the portion of income falling within their jurisdiction.²⁴⁷ Each item of income would therefore be taxed only in one country and exempt in the others, with a consequent *pro rata parte* attribution of personal and family-related benefits, as defined by national rules of each State.²⁴⁸

As Van Raad clarifies, the FT approach can be summarized in three steps to be taken by the State from which the taxpayer derives income: i) calculate taxpayer's worldwide income; ii) apply its rates to that income and iii) apply to the resulting tax the ratio between domestic income and worldwide income (both computed under the given State's rules).²⁴⁹

Fractional taxation is in line with the subsidiarity principle, because it maintains Member States' fiscal sovereignty as intact as possible, recognizing their freedom to independently determine tax bases, tax rates and personal tax benefits.²⁵⁰ Furthermore, such solution would only require a cooperation between Member States to determine taxpayers' worldwide income and, accordingly, applicable tax rates.²⁵¹ As Wattel points out, fractional taxation could be implemented by the ECJ on basis of the directly effective fundamental freedoms provided for by the Treaty, through a negative integration process and, thus, without requiring harmonization measures by the European Council.²⁵²

4.3 Conclusions

Foundations of the ability to pay principle can be found in EU primary law. In particular, ability to pay can be seen as a corollary of the equality principle, recognized as a general principle of the Community by the Treaty of European Union, the Charter of Fundamental Rights and the ECJ's case law. Constitutional rank of the principle of ability to pay rests also on recognition of human dignity, social justice and solidarity as fundamental values of the European legal order, stated both in the above mentioned Charter and the TEU. Moreover, the protection of family life and of the peaceful enjoyment of possession, granted respectively by the Charter of Fundamental Rights and the European Convention of Human Rights, constitute aspects of ability to pay concept of taxation and can therefore be seen as hints towards its nature of general principle.

However, even if Dworkin's theory excludes judicial law-making process, a general principle, to be recognized as such and, accordingly, as an unwritten source of EU law, necessarily needs to be implemented by the Court of Justice. Nevertheless, the ECJ has never expressly identified the ability to pay as a general principle of EU law. On the contrary, an accurate analysis of the case law dealing with tax benefits relating to personal and family circumstances has shown, against our expectations, that the European Judges have not always ruled in line with that principle.

²⁴⁶ Before Wattel, however, Van Raad had already thought about a fractional approach in his article 'Fractionele belastingheffing van EU buitenlands belastingplichtigen', in *Liberale Gifte* (Festschrift Ferdinand Grapperhaus), Kluwer, 1999.

²⁴⁷ Bardini (n. 227), p. 19.

²⁴⁸ Ibid.

²⁴⁹ Van Raad K., 'Non -Residents - Personal Allowances, Deduction of Personal Expenses and Tax Rates', in *World Tax Journal*, vol. 2, n. 2, 2010, p. 160.

²⁵⁰ Wattel (n. 226), pp. 222-223.

²⁵¹ Bardini (n. 227), p. 19.

²⁵² Avery J., 'A Comment on "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances"', in *European Taxation*, vol. 40, n. 8, 2000, p. 376.

Accordingly, ability to pay can't be considered a general principle of EU law.

In particular, the ECJ has not been recognizing one of the two symmetrical and inseparable aspects characterizing the ability to pay principle in cross-border situations. Indeed, requiring personal and family circumstances to be taken into account once somewhere, that principle implies elimination of tax disadvantages for taxpayers but, at the same time, also prohibition of double-dip situations. The risk that the taxpayer enjoys a double benefit has been, however, expressly accepted by the Court in *de Groot, Wallentin and Imfeld & Garcet*.

From our investigation it can be concluded that what matters to the Court is non-discrimination of individuals who wish to enjoy the benefits of the European Internal Market. Accordingly, in *Schumacker, Zurstrassen, Meindl and Beker*, the ability to pay principle has been used as a tool to avoid disadvantages for taxpayers exercising one of the fundamental freedoms granted by the Treaty. On the other hand, when ability to pay has been tested against non-discrimination principle, requiring the circumstances of the cases to rule according to one or the other, its value as self-standing source of law has been denied.

Our conclusions are confirmed by the fact that, in those cases where the Court of Justice hasn't recognized a restriction of the EU citizens' fundamental freedoms, no consideration has been given by the European Judges to the fact that personal and family circumstances of the taxpayer ended up being taken into account only partially (see *Gilly* and, to some extent, *Gschwind*).

The analysis we conducted has been limited to subjective ability to pay. However, since the objective aspect of that principle has been dealt with by the ECJ in a number of interesting cases,²⁵³ further research could carry out an investigation analogous to ours, in order to verify in detail the status of the ability to pay also in those rulings. Such analysis would be particularly interesting in light of the *Hirvonen* pending case,²⁵⁴ where the European Judges are called upon to face a clear cherry-picking situation.²⁵⁵ Whether they will decide to allow or deny the possibility for the plaintiff to enjoy both low tax rates provided for non residents by Swedish law and, at the same time, interest deductions recognized by the latter to residents, will give an important signal to understand the direction followed by the Court. The ECJ might, as it has done so far for subjective ability to pay, continue to use that principle only if needed as a tool for the protection of fundamental freedoms or, on the contrary, undertake a new approach based on the full recognition of the ability to pay and its impact on both tax disadvantages and double dips. If the latter scenario will occur, the way towards fractional taxation might reveal more accessible than it appeared until this moment.

²⁵³ See, for instance, Case C-234/01, *Arnoud Gerritse v Finanzamt Neukölln-Nord*, 12 June 2003, EU:C:2003:340; Case C-152/03, *Hans-Jürgen Ritter-Coulais, Monique Ritter-Coulais v Finanzamt Germersheim*, 21 February 2006, EU:C:2006:123; Case C-527/06, *R. H. H. Renneberg v Staatssecretaris van Financiën*, 16 October 2008, EU:C:2008:566; Case C-735/12, *Margaretha Bouanich v Direction départementale des finances publiques de la Drôme*, 13 March 2014, EU:C:2014:138.

²⁵⁴ Case C-623/13, *Hirvonen* (pending).

²⁵⁵ For an analysis of the case see Brokelind C., *Hirvonen*, H&I, n.4, 2014, pp. 28-31.

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