Universitat Abat Oliba CEU

# Ponencia presentada en el Second Joint Seminar in Tax Law: Influence of European Case Law on Direct Taxation.
# Free movement of capital (I): Juridical double taxation by cross border transactions: the Block Case (C-67/08)

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Barcelona, 10 de Julio de 2010

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## Summary

## Introduction

Treaty Establishing the European Community, operative until December 1st 2009, had already established in its article 2 the mission of the up until then European Community and actual European Union is to promote an harmonious, equilibrated and sustainable development of the economic activities of the whole Community. This Mission must be achieved by establishing a Common Market, an Economic and Monetary Union and the realization of Common Policies. One of the instruments to obtain these objectives is the use of free circulation of people, services and capitals inside the Common and Interior Market of the European Union. The European Union is characterized by the confirmation of the total movement of capitals, services and individuals and legal peoples' freedom; freedom that was already predicated by the Maastricht Treaty, through the suppression of whatever obstacles which are in the way of the objectives before exposed. The old TEC in its Title III, now Title IV of the Treaty on the Functioning of the European Union, covered the free circulation of people, services and capitals. Consequently, the inclusion of this mechanism inside one of the regulating texts of the European Union indicates the importance this freedom supposes for the European Union objectives' development. Once stood up the relevance of the free movement of people, services and capitals, we must mention that in this paper we are going to centre our study in one of these freedoms of movement: the free movement of capital.

In order to analyze in detail the free movement of capital within the European framework, we are going to depart from the analysis of the existent case law of the Court of Justice of the European Union. The use of jurisprudence is basic to know how Community legislation is interpreted. For this reason, we are going to develop this work through judgements dictated by the European Union Court. This way we can observe how Member States' regulating laws and the European Common Law affect the free movement of capital. The starting point of this paper will be the Judgement C-67/08 European Court of Justice of February 12th 2009, known as Block case. So, following the argumentation the Luxemburg Court did about the mentioned case, we are going to develop how free movement of capital could be affected by the current disparity of Member States' legislation. This disparity can produce double taxation cases due to the lack of tax harmonized legislation within the interior market and the lack of treaties to avoid double taxation within the European Union. Developing this idea we

are going to see how double taxation, at least indirectly, can infringe free movement of capital.

## 1.- The Block Case

Member States' internal rules can be considered restrictions on the principle of free movement of capital and, consequently, on the common market. The actual situation of the European Common Law entails, in some cases, the payment of two equivalent taxes in two different Member States. This situation occurs because of the lack of legislation regulating which Public Treasury is the responsible of the exaction when the realization of the same tax event in different States implies the payment of two assimilated taxes in every States' Treasury, generating a greater fiscal burden for the European taxpayer. This way, double taxation suppositions are produced within Member States of the European Union. As we can see, at the same time, it affects the European Union founding principles, such as free movement of capital, which can be damaged. We are going to develop this idea, as we mentioned before, starting from the analysis of the Block Case. In the ruling of this case we can see difficulties the European Court of Justice had to face up when it comes to give judgement.

Therefore, we are going to expose which is the proposal of the case: Ms. Block, who is resident in Germany, is the only inheritor of German resident who died in 1999 in Germany. The inheritance consists, basically, in capital assets invested some in German financial institutions and others in Spanish financial institutions. Ms. Block found, for the simple fact of inherit capital assets located in Spain, she was carrying out the tax event of the Spanish Inheritance and Gift Tax, as establishes article 3.1 of the Spanish Inheritance and Gift Tax[1]. This tax is considered a personal obligation for all the taxpayers who are residents in Spain. Therefore, people who are non residents and who inherit goods or rights located in Spain are also held to this tax, no matter their residence. That is because this tax is also qualified as a real obligation for all those purchasers *of goods and rights, whatever their nature is, which are situated, could be exercised or would have to be carried out in the Spanish territory*, as

[1] Law 29/1987, 18 December, of Inheritance and Gift Tax.

article 7 of the mentioned Spanish Inheritance and Gift Tax Law establishes. Consequently, Ms. Block had to pay the corresponding sum of that tax, as she was considered tax payer of the Spanish Inheritance Tax. Nevertheless, when Ms. Block received her Notice of Assessment on 14th March 2000, she discovered Finanzmt Kaufbeuren (German Treasury) *fixed the inheritance tax payable by Ms Block in Germany without taking into consideration the inheritance tax paid in Spain*[2]. That is why Ms Block lodged an objection to that Notice of Assessment, requesting the Spanish Inheritance Tax she had already paid in Spain to be credited against the German Inheritance Tax. This way, being the Spanish Inheritance Tax much greater than the Germany one, the amount in excess would be repaid to her. However, Finanzmt, responding to her objection, established that solely should be deducted the Spanish tax liability from the basis of Inheritance Tax payable in Germany, not from the tax burden. Thus, once made all the deductions, Ms. Block had an amount of Inheritance Tax she had to pay to the German Treasury.

We can see that we are in front of a double taxation case, because the same capital goods are taxed for two Taxes that are equivalent in both States: Germany and Spain. We can find in the German Law the justification to not credit the inheritance tax which had already been paid in Spain against the inheritance tax payable in Germany. The German Law of the Inheritance and Gift Tax establishes that the payment of this tax is an obligation for all German residents. Then it is also an obligation for all those assets object of transmission when the deceased or the inheritors have the condition of residents. The own German Law specifies inheritors have the right to credit the foreign Inheritance Tax against the German tax when their inherited foreign assets are hold to a similar Inheritance Tax in another country[3], as long as that assets are equally hold to the German Inheritance Tax.

German Law also establishes, when the deceased is not a resident in the German State and lefts to their inheritors (even they are not German residents) capital claims located in a financial institution of another Member State, the Inheritance Tax that had already been paid in that other State is going to be credited against the German Inheritance Tax, because these capital claims are considered “foreign assets”. Thus, we can see there is a difference of treatment between residents and non residents. Nevertheless, according to the same

2This fragment has been taken literally from the paragraph 10 of the Block judgement.
3 This operation can be accomplished when there is not any double taxation treaty between Germany and the other Country where there are located the taxable goods.

German Law, capital claims inherited by Ms. Block do not constitute “foreign assets”, as article 21 of the German Inheritance Tax Law establishes. “Foreign assets” are constituted by the total amount of assets located in other Countries as long as they are stated in the list of the article 121 of the Valuation Law, as long as the deceased is a German resident. Consequently, being capital claims the assets inherited by Ms. Block, as they are not stated in the list of article 121, the Spanish Inheritance Tax paid for them can not be credited against the German Inheritance Tax, generating, in consequence, a double taxation case[4].

The Federal Finance Court (Bundesfinanzhof) observed double taxation was produced because of the inexistence of a European Common Law that harmonizes the concept of “foreign assets” among Member States. In front of that dilemma, the Bundesfinanzhof decided to ask some queries to the Court of Justice of the European Union. The Court wondered whether such double taxation was contrary to Community Law, because it produces a restriction on the free movement of capital regulated in the article 63 TEU (old art. 56 TEC). The queries we are interested to analyze, are the following ones (in a summarized way):

- Must the art 56 EC (actual 63 TEU) be interpreted as meaning that Inheritance Tax which another European Union Member State levies for the acquisition of capital claim, by a Germany resident heir, that a testator, last resident in Germany, had in a financial institution in that other member State must be credited against German Inheritance Tax?

- Do the provisions of art. 58.1.a) EC and 58.3 EC (actual 65 TEU) exclude in inheritances opened in 1999, the crediting of the Spanish Inheritance Tax against German Inheritance Tax?

Once exposed which is the main problem the case poses, we must see whether article 63 TEU and article 65 TEU, which are referred to the free movement of capital within the European Union, must be interpreted as meaning that they are opposed to the Member State

[4] García de Pablos, J.F., in Resumen de la Tesis *El Impuesto sobre sucesiones y donaciones: Problemas Constitucionales y Comunitarios,* Instituto de Estudios Fiscales Doc. Num. 20/09, p. 83 (translated from the original in Spanish): Developing this idea he says: "The prohibition of a discriminatory tax treatment means that EU Member States can not treat foreigners (citizens of other EU Member States) in a manner less favorable than their own citizens." However, we have observed that in the German case "discrimination" occurs in reverse way.

Laws that do not plan the capacity of crediting the Inheritance Tax of another State, that had already been paid, against the Inheritance Tax of the State where European citizens are residents. For example, in the judgement C-67/08, Ms. Block must pay two equal taxes for the same assets, because German Law does not prevent crediting the Spanish Inheritance Tax, which had already been paid in the Spanish Treasury, against the German Inheritance Tax. This double taxation is the result of not considering capital claims deposited in foreign financial institutions as “foreign assets” by German Law.

## 2.- Why a restriction of free movement of capital?

Article 63 TEU (old art. 56 CE) established that […] all restrictions on the movement of capital among Member States and among Member States and third countries shall be prohibited. We can see clearly that, any actuation executed by Member States contained in their legislations never have to restrict the free movement of capital. Nevertheless, in spite of what is provided in article 63 TEU, article 65 (old article 58 EC) permits Member States to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested. Therefore, partly, the Treaty on the Functioning of the European Union leaves a margin for the States themselves, permitting to establish a difference of treatment in their internal Laws. Yet, we must take into account that this difference in the treatment can not suppose neither a mean of arbitrary discrimination nor a covered restriction of the free circulation of capital and payments, as article 65.3 TEU indicates. Once we have exposed the precepts of European Common Law in which we are interested in for this case, it proceeds to examine whether, as Ms. Block alleged, German national Laws constitute a restriction for the free movement of capital when a person resident in Germany dies and leaves to an other person, also resident in the same State, some capital claims which have been deposited in a financial institution located in Spain and which have been taxed twice by the Spanish and the German Inheritance Taxes.

We have to start from the fact that, as the old Directive 88/361 established, inheritances are entitled “Personal Capital Movements”; in other words, it is about capital movements’ in the sense of article 63 TEU defines them, as long as these capital movements are located in

more than one Member State, not only within just one single State. Then, when in inheritance acquisitions there are assets located in some different Member States, it turns out that, it is directly applicable that prohibition of restricting any free circulation of capital, including in this prohibition all actions that can cause a decrease in the value of an inheritance. Consequently, when Ms. Block receives as inheritance the capital claims deposited in Spain, a Member State, this transaction constitutes a movement of capital. Even though, direct taxation is a Member States' competence, different laws regulating these movements of capital can not contradict the principles of the European Union, as, for example, free movement of capital; respecting, moreover, the European Common Laws.

In opinion of Ms. Block, German legislation supposes a restriction for the mentioned principle of free movement of capital. She justifies her formulation arguing that not all the inherited assets located in other Member States, different than the State where the deceased had the last residence, give the right to credit the Inheritance Tax of these other States paid for them, as we could see in article 21 of German Inheritance Tax Law. We understand the concept "foreign assets", which give this right of crediting, does not includes some assets, such as capital claims, even if they are locate in a foreign country, as happens in the Block Case. This situation makes these capital claims to be taxed twice by the Spanish and the German Inheritance Taxes. As Ms. Block maintains, this risk of double taxation could dissuade the owners of capital claims to invest them in other Member States, above all in those States where tax rates are high, as occurs in some Spanish regions[5].

Even though, the Court of Justice of the European Union does not decides to rule in favor of Ms. Block. Despite the convincing argumentation Ms. Block gave us respect the injustice German rules suppose, the Court, answering to the queries presented by the Bundesfinanzhof, decides to rule establishing that neither article 56 EC nor article 58 EC (now articles 63 and 65 respectively) are opposed to Member States' Laws that do not contain the capacity of crediting the Inheritance Tax of another Member State which has already been paid against their own Inheritance Tax, that taxes the same inherited goods. Consequently, we can deduce from this answer that, the Court considers German rules - which do not contain the possibility of crediting the Inheritance tax paid in another Member

[5] We must remember that in Spain, regulating capacity of Inheritance Tax has been transferred to the subcentral entities.

State's Treasury for the capital claims located abroad, when the deceased and the heir are German residents, against the German Inheritance Tax - perfectly correct.

The reason for The Court to rule in this sense it is due to the fact that there is a lack of European Common rules in these subjects. Therefore, the Court, in its paragrafh 27 of the Judgement, admits that some inherited goods, as capital claims are, are excluded from the concept "foreign assets" -that gives the right to credit the Inheritance Tax already paid abroad, in the State where capital is deposited, against German Inheritance Tax- causes a tax burden much more superior than the one Ms. Block would have paid if those capital claims had been located inside an only one Member State. The Court also establishes this tax disadvantage is due to the parallel exercise of taxing power by both Member States.

In this sense, the Court is aware of the injustice that existence of this disparity of rules causes to the European citizens. Therefore, we can not obviate that the Treaty itself allows these regulations to cause a difference of treatment, as article 63 TEU establishes. Therefore, according to the Luxembourg Court the fact that the German legislation subjects capital claims against German Inheritance Tax when the creditor resides in that member State (Ms. Block), and Spanish legislation subjects to Spanish inheritance tax these capital claims to the inheritance tax if the debtor (financial institution) is established in Spain (paragraph 28 of the judgement C-67/08 Block), it does not constitutes a violation of the freedom of movement of capital because they are legislations that are inside the permitted margin by article 63 TEU. This justification has already been used in previous case law, for example, in the case C- 513/04 Kerckhaert and Morres or in the case C-298/05, Columbus Container Services. In this last case, the Luxembourg Court ruled in the judgement the same answer as in the Block case, but in the framework of the Belgian Income Tax, sentencing that the Court was not against legislation of a Member State (Belgium) that taxed at same uniform tax rate on dividends from share options of companies established in the State itself and in another Member State, without foreseeing the possibility of crediting the tax levied by making a deduction in the source of that other member State.

Apparently, the Luxembourg Court did not consider the excessive tax burden on the European taxpayers is causing a restriction on free movement of capital[6]. Therefore, in judgements as case C-298/05 Columbus Container Services, in its paragraph 43 the Court admits the adverse consequences that might entail the application of this system of taxation, result of the exercise in parallel by two Member States of their fiscal sovereignty. Moreover, judgement points out in its paragraph 44 that, in fact, double taxation conventions serve to "eliminate or mitigate the negative effects on the functioning of the internal market resulting from the coexistence of national tax systems" argument also used in paragraph 29 of the Block judgement. Therefore, if we go by these regulations it turns out to be obvious that the absence of double taxation between Member States or the lack of harmonization of tax rules at European level may cause a breach in the internal market, which, therefore, must be reached by principles such as freedom of capital movements among Member States.

However, Community Law, in its current state and in a situation such as the procedure that we are analyzing "does not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation within the European Community[7]" Until the date there is only two Directives and one only Convention to adopt measures for tax harmonization within the European Union[8], so we can say that, up to now, no truly effective measures of unification have been taken in order to eliminate situations of double taxation[9]. For this reason, as there are no general criteria for the allocation of competences among Member States in order to eliminate double taxation, States have autonomy to exercise their powers of taxation as they consider. In front of this argument, the European Court of Justice justifies why the Court is not opposed to legislation that does not include the capacity of crediting an Inheritance Tax, already paid in a member state, against the German Inheritance Tax. According to the Court, as the Member States have their autonomy, they *are not obliged to adapt their own tax systems to the different systems of tax of the other Member States in order, inter alia, to eliminate the double*

[6] This excessive tax burden Ms. Block has to face is caused by the double taxation generated by the disparity of legislations Member States have. There is no European Legislation because Member States have the taxing power in the inheritance subject.
[7] Paragraph 30 of the Block Judgement.
[8] Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
Convention of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises
Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments
[9] It is stood up by García de Pablos, J.F., o. c., p.84.

*taxation arising from the exercise in parallel by those Member States of their fiscal sovereignty*[10]. Following the Court's arguments people are free to choose Spain, or another Member State, to deposit some capital claims in one of the financial entities located there, then they can not require the Spanish State to adapt their tax legislation in order to avoid double taxation with the German Inheritance Tax. Using the taxing power of the Member States and the lack of European harmonization as a justification is also used in Judgement C-298/05 Columbus Container Services case[11].

Consequently, for the Luxembourg Court the difference of treatment produced in the German State, being the deceased a German resident or a non resident, does not generates a violation of the freedom of capital movement. The Court establishes that the differences on the treatment that occur in the German legislation at the time of charging the tax already paid, taking into account the creditor's residence, it is a decision the State can adopt freely. As there is any European Directive for all Member States establishing what de they have to do, States can legislate according to their own interests without violating any European rule.

Furthermore, the Treaty on the Functioning of the European Union does not guarantee to a citizen of the Union that the transfer of residence from one Member State to another will not turn into negative effects in terms of taxation, counting on the different legislations, the transfer may be more or less advantageous, and may or may not result in double taxation. For this reason, the Court decides to rule saying that Articles 56 EC and 58 EC (now 63 TEU and 65 TEU) do not precludes legislation of a State which does not contains in its legislation the mentioned charge against its own tax. According to the Court, double taxation, derived from the autonomy of taxing power Member States have, can not cause interferences in the achievement of the objectives of the European Union.

[10] Case C-67/08 paragraph 31.

11 Paragraph 51 of the Judgement C-298/05, Columbus Container Services: *It follows from that tax competence that the freedom of companies and partnerships to choose, for their purposes of establishment, between different Member States in no way means that the latter are obliged to adapt their own tax systems to the different systems of tax of the other Member States in order to guarantee that a company or partnership that has chosen to establish itself in a given Member State is taxed, at national level, in the same way as a company or partnership that has chosen to establish itself in another Member State.*

## 3.- Final Reflexion

Even though the Court of Justice of the European Union recognizes double taxation Conventions are designed to eliminate Interior Market's failures resulting from the coexistence of national tax systems from different Member States. In the current situation European legislation can not oblige Member States to elaborate a national legislation in order to avoid this double taxation. Double taxation is an everyday problem of the European Union, but instead of recognizing it the Court acts validating and justifying those legislations that lead to double taxation cases, as we have seen in Block. Nevertheless, the Court itself demonstrates that nowadays it is impossible to face up the potential danger that lies in this disparity of legislation and the lack of Conventions. There is no European Legislation enough to avoid double taxation among Member States. This way, it turns out to be impossible to ensure a plenty free movement of capital among members of the European Union without paying the price of double taxation.

Consequently, we could speculate that, despite the Luxembourg Court does not considers this way, the disparity of legislation can lead to a violation of the free movement of capital, in an indirect way. Following the logic and the principle of saving, whether having capital in another Member State supposes a tax duplicity which levy corresponds to Treasuries of the other Member States where the funds are established, this would imply the citizens of the Union to choose not to invest in these other States that are not their ones or to withdraw the invested capital, in order to avoid this tax burden[12]. So, this would produce a decrease on the wealth of these Member States in which the citizens were investing, all in order to avoid this double taxation on their capital. Therefore, we would have to wonder whether certain Member States' legislation can suppose an infringement of the free movement of capital. If it is this way consequently, this legislation can make more difficult the aim of achieving an internal market. Thus, it means that, nowadays we are far of reaching the full objectives of the European Union.

12 García de Pablos, J.F., o. c., p. 96 (translation from the original in Spanish) corroborates to us this reflection by the development particularly in the Spanish case. Thus, he says: "there would be a restriction of capital […], because the measure may dissuade the non-resident deceased to do investments in Spain, because they will not give any right to make reductions, even if the assignee is resident in Spain. Definitively, the non resident deceased will not enjoy, in any case, of regional reductions, regardless of the residence of the heirs, although its properties are located in our country [Spain], so the non-resident can be deterred from making investments in Spain".

We believe, unlike the Court, double taxation produces restrictions on the European Common freedom of movement of capital. Moreover, double taxation causes discrimination for those who want to carry out intra-communitarian and cross-border operations, against those who only invest in one Member State, their own one. Member States disparity of internal legislation means that it is better not to invest in other EU countries, because if European citizen do it, they are going to receive the same treatment as for a third State, non member of the European Union. The Court in front of that objection, chooses the easiest solution, and decides to deny the violation of Community freedoms[13]. The Court in front of such an objection decides to choose the easiest solution, and decided to deny the breach of Community freedoms. What we say we have seen it in the cases mentioned throughout this paper: the Block Judgement (C-67/08), Columbus Container Services (C-298/05) or Kerckhaert and Morres (C-513/04)[14]. However, we should recognize that finding a solution to the situation is not that easy. All Member States are holders of the taxing power, which has not been ceded to the EU. Therefore, their have their right to establish legislation they think is more convenient to protect their own interests.

Furthermore, eliminating article 293 TCE[15] by the Treaty of Lisbon, it is going to be given the full freedom of action to Member States, producing a reversal for European Institutions in subjects like taxation. At the same time, the elimination of this article would cause a removal to achieve tax harmonization and a full Internal Market. European Union itself admitted, years ago[16], problems resulting from the current lack of co-ordination between EU and Member States in this subject would increase even further. In this situation we can apply different solutions: on the one hand, the establishment of a harmonization Directive and, on the other hand, the establishment of a Multilateral Convention covering all Member States. Both solutions could be applied in order to ensure avoidance of double taxation between Member States. European Union had aspirations of gaining support and meeting with a

13 Herrera Molina, Pedro M., *Convenios de Doble Imposición y Derecho Comunitario*, Instituto de Estudios Fiscales, 2009, p. 304 (translations from the original in Spanish), considers that the dogmatic structure of this approach can be summarized as follows: if we were faced with a discrimination it would require that the Court will determine which of the Member States would be required to eliminate double taxation, but the Treaty EC does not provide rules for the distribution of powers, so it would be unacceptable that the Court would exercise a policy option imitating the sovereignty of the States.

14 It is stood up by: Herrera Molina, Pedro M., op. cit., pág 305.

15 Article 293 TEC (repealed by the Treaty of Lisbon) was requiring Member States to enter into negotiations with each other with a view to the abolition of double taxation within the Community.

16This web of the European Union explains it:
http://ec.europa.eu/taxation_customs/taxation/personal_tax/double_tax_conventions/index_en.htm

constructive attitude from Member States achieving a gradual and measured co-ordination, however, the complexity of economic and political interests of States makes not that easy to find the most appropriate solution. Applying a multilateral Convention, States would not loose their taxing power and they would not depend on a superior structure, as the European Union is, in the taxing subject. Yet establishing a European Directive would give the power to the European Court of Justice to solve double taxation cases among Member States, making closer a fully free movement of capitals within the interior market.