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ECJ Condemns Belgian Minimum Tax Base for Nonresidents

by Marc Quaghebeur

In *Raffaele Talotta v. État belge* (C-383/05), the European Court of Justice has condemned the rule under Belgian law that allows Belgian tax authorities to assess nonresidents on minimum tax bases in the absence of evidence provided by the interested parties. Applying that rule exclusively to nonresidents is contrary to the freedom of establishment provided for by article 43 of the EC Treaty, the ECJ said. (For the ECJ judgment, see *2007 WTD 58-12* or *Doc 2007-7256*.)

The Belgian Parliament appears in which complied with the March 22 decision by extending the application of the rule to Belgian residents. However, that will not be the end of the discussion.

Direct Taxation and Community Law

Direct taxation is one area in which the European Commission has made little progress in its fight against the obstacles to the creation of a true internal market. Despite years of negotiations, the commission can claim only a few achievements: three directives on the taxation of enterprises[1] and one on the taxation of individuals.[2] In fact, the ECJ has made far more progress in the past decade.

Direct taxation has stayed outside community law precisely because it touched one of the fundamental powers of national governments — the right to levy and collect taxes. And of course, member states are defending their privileges. It took the ECJ 30 years to venture into the area of direct taxation — first with a solitary decision in the French *Avoir Fiscal* case in 1986,[3] and then reticently in Bachmann in 1992.[4]

The European Community has just celebrated its first half century, and in the first 30 years of its existence, the ECJ handed down only one judgment on direct taxation. In the following decade, it followed up with 13 more decisions, but in recent years, it seems to have really gained speed. In 2006 the ECJ rendered 16 decisions of direct relevance to direct taxation, and 8 more in the first quarter of 2007 alone.

The ECJ has clearly outlined the playing field for the EU member states. In all its direct taxation cases, the Court's opening statement is that "according to settled case law, direct taxation falls within the competence of the Member States, but the Member States must nonetheless exercise that competence in a manner consistent with Community law."

Even the lower courts have discovered that they can use EU law, and the case law of the ECJ, to oppose some domestic provisions of direct taxation. Nevertheless, it is still surprising that some cases are actually referred to the ECJ.

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[1]Council Directive 90/434/EEC of July 23, 1990, on the common system of taxation applicable to mergers, divisions, transfers of assets, and exchanges of shares concerning companies of different member states, [1990] OJ L225/1; Council Directive 90/435/EEC of July 23, 1990, on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states, [1990] OJ L225/6, corrigendum at [1991] OJ L 23/35; and Council Directive 2003/49/EC of June 3, 2003, on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states, [2003] OJ L 157/49.

[2]Council Directive 2003/48/EC of June 3, 2003, on the taxation of savings income in the form of interest payments, [2003] OJ L 157/38.

[3]Case 270/83 of Jan. 28, 1986, *Commission of the European Communities v. French Republic*, [1986] ECR, 273.

[4]Joined cases C-204/90, *Hans-Martin Bachmann v. Belgian State*, and C-300/90, *Commission of the European Communities v. Kingdom of Belgium*, Jan. 28, 1992, [1992] ECR, p. I-249.

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The *Talotta* judgment is a case in point. More than a quarter of a century ago (but before the French *Avoir Fiscal* case), Belgian commentators pointed out that this rule was discriminatory. But this is the first time that a court — and the Supreme Court at that — has taken that warning seriously. Not surprisingly, the ECJ handed down a short decision giving the Supreme Court a rap on the knuckles.

Background

The appellant, Raffaele Talotta, is a Luxembourg resident who runs a pizzeria across the border in Arlon, Belgium. He is subject to Belgian income tax as a nonresident. The Income Tax Code has a separate section on nonresident individuals.

Because Talotta was late in submitting his tax return for 1991 (tax year 1992), the tax authorities levied the income tax on a minimum taxable profit in accordance with article 342 of the Belgian Income Tax Code 1992, which states that in the absence of evidence provided by the taxpayer, his profits will be determined by reference to the normal profits of at least three similar taxpayers[5] and that for foreign undertakings operating in Belgium, a minimum taxable profit shall be established in a royal decree.

Article 182 of the royal decree implementing the Income Tax Code 1992 provides a minimum taxable profit for the Belgian branches of foreign undertakings operating in Belgium. For undertakings in the hotel and restaurant sector, the minimum taxable profit is 10 percent of the turnover, with a minimum of BEF 300,000 (€7,437) per employee. There is, however, an overall minimum of BEF 400,000 (€9,916, increased to €19,000 since tax year 2007).

Because Talotta had a staff of six, he was assessed on a taxable profit of BEF 1.8 million (€44,620). He filed a complaint against that taxation, but it was dismissed by the tax authorities. He then appealed the assessment before the Court of Appeal in Liège on the basis that the minimum taxable profit was contrary to the income tax treaty between Belgium and Luxembourg and to the free movement of persons (and in particular, the right of establishment) in article 43 of the EC Treaty.

The Court of Appeal rejected both arguments. First, it confirmed the prevailing case law that the principle of equal treatment provided for by an income tax treaty does not rule out that for practical reasons, a foreign enterprise can be taxed differently than a Belgian enterprise.[6] Moreover, article 7(4) of the treaty does not prevent the use of a system of lump sum taxation. The court also pointed out that a foreign enterprise can avoid lump sum taxation by presenting its accounts in due form.

As for the argument regarding the freedom of establishment, Talotta had based his case on an ECJ judgment involving the carryforward of losses by a nonresident taxpayer (presumably *Mertens* (C-431/01)). The court rejected that argument because it considered it completely irrelevant to the case at issue.

The Supreme Court subsequently upheld the decision of the Court of Appeal on the application of the income tax treaty, but decided to stay proceedings pending a preliminary ruling from the ECJ on the following question: "Is . . . Article 52 . . . of the EC Treaty to be interpreted as prohibiting a provision of national law, such as Article 182 of the Royal Decree of 27 August 1993, implementing Article 342(2) of the Income Tax Code 1992, whereby minimum tax bases are applied only in the case of non-residents?"

The ECJ Decision

The ECJ did not have to think for long to conclude that the Belgian rule is discriminatory. Article 342(1) of the Income Tax Code 1992 regulates situations in which the taxpayer, resident or nonresident, has not provided tax authorities with evidence regarding its profits or earnings.

However, it is only in the case of nonresident taxpayers that, in the absence of evidence, the tax authorities must determine the turnover by applying the minimum tax bases. For resident taxpayers, the profits can be determined by way of a comparison with the normal profits of at least three similar resident taxpayers, or with the flat-rate method of taxation on the basis of "signs or indications that the level of economic well-being enjoyed is higher than that accounted for by the income declared."

That rule clearly treats resident and nonresident taxpayers differently. In keeping with the French *Avoir Fiscal* case, the ECJ refused to accept that the member state of establishment may apply minimum tax bases solely to nonresident taxpayers merely by reason of the fact that their tax residence is situated in another member state; that would deprive article 52 of the EC Treaty of all meaning. Furthermore, the income in question is not different from that received by a resident taxpayer in the same situation; it is income arising from self-employed activities carried out in the territory of the same member state.

[5]To determine whether other taxpayers are similar, the tax authorities must consider the capital invested, the turnover and the number of workers, the source of power used, the rental value of land used, and any other relevant information.

[6]Court of Appeal, Brussels, June 30, 1994, re *K*.

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The Belgian government then tried to establish that there are objective differences between residents and nonresidents regarding the means of proof available to tax authorities for purposes of establishing the base of the taxable income. When a nonresident taxpayer carries out operations in part in the member state of establishment and in part in another member state, the procedure for exchange of information provided for in the mutual assistance directive[7] is neither realistic nor effective in overcoming the practical problems involved in the application of comparison-based taxation, it said.

The ECJ dismissed that argument. In cases of cross-border activities, resident and nonresident taxpayers present the same difficulties for tax authorities, so they are in an objectively comparable position, it said. For the rest, the ECJ referred to its case law that a member state may rely on the mutual assistance directive to obtain information from the competent authorities of the other member state to ascertain the correct amount of income tax payable by a taxpayer under the legislation that it applies.[8] And even assuming that the Belgian tax system is more often favorable to nonresident taxpayers — as the Belgian government had argued — when that system proves disadvantageous for them, it results in unequal treatment, thereby creating a hindrance to the freedom of establishment guaranteed by article 52 of the EC Treaty.[9]

The ECJ therefore concluded that the Belgian rule constitutes indirect discrimination on the grounds of nationality within the meaning of article 52 of the EC Treaty, because nonresidents are, in the majority of cases, foreigners.

The Belgian government failed to justify the discrimination by establishing that the application of the minimum tax bases only to nonresident taxpayers is justified by the need to ensure the effectiveness of fiscal supervision.[10] The ECJ reiterated that it cannot accept that the practical difficulties apply differently to resident taxpayers because Belgium has the ability to enter into an exchange of information with other member states on the basis of the mutual assistance directive.

In the absence of any acceptable justification, the treatment applied to nonresident taxpayers must be identical to that provided for resident taxpayers, the ECJ said. Therefore, it concluded that a rule that lays down minimum tax bases only for nonresident taxpayers is contrary to article 52 of the EC Treaty.

Conclusion

The outcome was foreseeable; it is entirely in line with the case law of the ECJ. In the meantime, however, the question had become largely irrelevant because the Belgian Parliament extended the application of the rule to Belgian enterprises and Belgian resident professionals who fail to file their tax returns or who file it late (article 342, section 3, Income Tax Code 1992).

The legislature was not anticipating the decision; it was only a couple of months later that the Supreme Court referred *Talotta* to the ECJ.

The introduction of the rule establishing minimum tax bases for defaulting taxpayers was meant only to encourage taxpayers to file their tax returns. It was believed that such a rule would help overcome the objections of taxpayers that assessments of profits determined by comparison with the normal profits of at least three similar resident taxpayers, or by using the flat-rate method of taxation on the basis of "signs or indications that the level of economic well-being enjoyed is higher than that accounted for by the income declared," were arbitrary and, therefore, not duly substantiated.

However, even now that both resident and nonresident taxpayers face the risk of paying corporate income tax on a minimum tax base of €19,000 in the absence of evidence provided by the interested parties, there is still a difference in the treatment of resident and nonresident taxpayers. The Belgian tax authorities can no longer determine the profits of a resident taxpayer on that minimum tax base if the taxpayer files a valid tax return. A nonresident taxpayer cannot escape the minimum tax base by filing a tax return.

The discussion about the issue is not entirely closed yet, but it is hoped that the lower courts will be able to eliminate that final discriminatory aspect and deny tax authorities the right to determine the profits of a nonresident taxpayer on the basis of minimum tax bases if he has filed a valid tax return. ◆

♦ *Marc Quaghebeur is with Vandendijk & Partners in Brussels.*

[7]Council Directive 77/799/EEC of December 19, 1977, concerning mutual assistance by the competent authorities of the member states in the field of direct taxation, OJ 1977 L 336, p. 15.

[8]*Skandia and Ramstedt* (C-422/01), [2003] ECR I-6817, para. 42.

[9]That case law is in reference to *AMID* (C-141/99), [2000] ECR I-11619, para. 27.

[10]That constitutes an overriding requirement of general interest capable of justifying a restriction on the exercise of fundamental freedoms guaranteed by the EC Treaty (see *Baxter and Others* (C-254/97), [1999] ECR I-4809, para. 18).