

Greece:

The Commission v. Greece Case

Theodore Fortsakis/Katerina Perrou

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I. Introduction

The pending case involving Greece (C-406/07) concerns two separate issues: the first is about taxation of inbound dividends; the second about taxation of foreign partnerships. Each issue will be treated separately.

II. Taxation of Inbound Dividends

Direct taxation in the European Union is being developed mainly through negative integration and the case law of the European Court of Justice (ECJ or the Court). The Commission has been the major driving force in this process, as it has the task of monitoring application of Community tax law.

This monitoring has recently moved from a rather reactive to a more pro-active infringement policy in general. In particular, monitoring the compatibility of the various Member States' rules on dividend taxation with Community rules has been one of the most important areas where the Commission has taken initiatives. Furthermore, the constant screening of Member State legislation also reveals rules that are not compatible with Community rules.

This is the broad context in which the case against the Greek provisions has been initiated.

2.1 The Greek legal background: taxation of individuals' dividend income

2.1.1 The taxation of the domestic dividend income of individuals

Since 1992 Greece applies the exemption system as far as domestic dividend income for individuals is concerned: the distributed profits are taxed at the level of the distributing company and the individual shareholders who receive dividends are not subject to any further taxation. There is no withholding tax levied on the dividend income and the dividends are not included in the taxable income of the recipient, either.

In particular, according to the provisions of the Greek Income Tax Code (Act No. 2238/1994, as amended), Greek tax residents are taxed in Greece on their worldwide income, including dividend income. According to Art. 54 para. 1, read together with Art. 114 para. 1, of the Greek Income Tax Code, dividends paid out by Greek resident companies are not subject to any kind of withholding tax, since those dividends arise from profits of the company that have already been taxed at the level of the company making the distribution. Furthermore, as Art. 114 para. 1 expressly provides, the corporate tax that is levied on the profits of the company out of which the distribution is made (currently 25%), is a final tax for the recipient of the dividend, and therefore no further tax is levied at the level of the individual shareholder.

This way the Greek rules relieve the dividend income from double economic taxation.

2.1.2 The taxation of individuals in case they receive inbound dividends – the application of DTCs

Greek income tax legislation treats the income from foreign dividends received by a Greek resident differently. In this case the classical system applies: the dividend income, irrespective of whether it has been taxed at the level of the foreign distributing company or not, is taxed again at the level of the Greek resident individual shareholder. The inbound dividend is added to the taxable income of the individual receiving the dividend and is taxed according to the individual progressive income tax rates (currently up to 40%).¹

According to Art. 24 para. 1b, foreign dividends are considered to be income from assets and are subject to taxation. Furthermore, the provisions of Arts. 54 para. 1 and 114 para. 1 apply only to dividends distributed by Greek companies and not to any kind of dividends. As a result, the income from inbound dividends is subject to a 20% withholding tax (Art. 54 para. 2) at the time it is paid out to the Greek recipient (Art. 54 para. 5d). This tax is withheld by the person or institution (usually a bank) that makes the payment of the dividend to the beneficiary (Art. 54 para. 6b).

Greece applies the credit method for the relief of double juridical taxation and therefore any tax that may have been withheld in the country where the company paying the dividend is resident can be credited against the individual income tax payable in Greece (Art. 9 para. 8). In order to get the tax credit, the taxpayer must provide the tax authorities with a certificate issued by the foreign person or institution that has withheld the tax on the dividend in the source country.² A similar certificate is also issued by the person or institution that is effecting the payment of the dividend in Greece (usually a bank).

The same effect is reached under the rules of the various double tax conventions (DTCs) that Greece has entered into.³ Any withholding tax that may have been withheld on the dividend at the source state is credited against the tax due by the individual in Greece (the residence state). Greece applies the ordinary credit method and therefore the source state tax that can be credited against the Greek tax is limited up to the amount of the Greek tax that would have been paid to the dividend in Greece.

¹ The Ministry of Finance has recently confirmed the application of these rules by the answer given to a taxpayer's question, as is mentioned in a document of the Ministry of Finance No. 1029649/20-7-2007, published in *LOGISTIS* 2007.

² This is stated in the guidelines issued by the Ministry of Finance that accompany the tax return and which are aimed at providing guidance to taxpayers on the correct submission of their annual tax return. This certificate is required as proof of the tax withheld in the source country. The application of this rule is mandatory regardless of whether the source state is a state with which Greece has a DTC or not.

³ Greece has signed DTCs with all EU Member States.

2.1.3 Juridical double taxation and economic double taxation of dividends in Greece

Under the Greek Income tax code rules, dividends of Greek companies paid to Greek residents are totally relieved from double taxation. There is no double juridical taxation on them because the company paying the dividend is only taxed once on its profits, before paying out the dividend. There is no double taxation on the shareholder either (juridical or economic), as the dividend income is exempt at the level of the individual shareholder receiving the dividend. Therefore, the total tax imposed on the income out of which the domestic dividend is paid equals the tax rate of the Greek corporate tax, which is currently 25%.

For foreign-source (inbound) dividends the treatment is different. In this case a dividend payment suffers juridical and economic (or even multiple) double taxation. First of all, the foreign company making the distribution is normally taxed in its residence state under that state's corporate tax rules. When the dividend is distributed, the company's state (source state of dividend) usually withholds a tax on the dividend income (which may be reduced, depending on the provisions of an applicable DTC). This dividend, when it is paid to a Greek individual tax resident, is also taxed in Greece according to the progressive income tax rates that apply in Greece for the taxation of individuals. The dividend is subject to both international juridical double taxation (tax imposed on the individual receiving the dividend by both the source state and the residence state) and international economic double taxation (tax imposed on the company profits in the source state and tax imposed on the dividend in both the source and the residence state).

For inbound dividends the international juridical double taxation is at least partially relieved by the application of either the domestic rule providing for the ordinary credit method or the applicable DTC rules, also providing for the ordinary credit method. The international economic double taxation, however, is not relieved, as the inbound dividend income is part of the taxable base of the individual Greek resident and is taxed according to the progressive scale provided for in Art. 9 of the Greek Income Tax Code (currently the highest rate is 40% and applies to income above EUR 75,000.00).

Within the EU there is one case where inbound dividends are also relieved from international economic double taxation: in the case provided for by the Greece-UK DTC. According to the Greece-UK DTC, an underlying tax credit is granted: the dividend distributed by a UK company and paid to a Greek resident is taxed in Greece, but credit is granted for both the tax that is paid in the UK on the dividend and the tax that is paid by the distributing company on its profits (pro rata to the paid dividend),⁴ notwithstanding the provisions of the Greek income tax legislation. Greece applies the ordinary credit method and therefore the maximum

⁴ Art. XIV of the Greece-UK DTC.

underlying tax credit equals the tax that would have been paid in Greece: the underlying tax credit that may be granted in such a case may not exceed 25% of the gross amount of dividend, where 25% is the current corporate income tax rate applicable in Greece.

Apart from this case, which is limited to the UK dividends received by Greek individuals, in all the other intra-EU cases international double economic taxation is not relieved.

2.2 The case brought before the ECJ by the Commission

2.2.1 Background to the infringement procedure

In October 2006, and in the follow-up of its report on the "Dividend taxation of individuals in the Internal Market",⁵ the European Commission sent a Reasoned Opinion (under Art. 226 EC) to Greece,⁶ asking Greece to amend the relevant legislation, because according to the Commission the Greek rules are contrary to EC law. One of the main conclusions of that report was that dividends paid from other Member States could not be subjected to higher taxes than dividends paid from within a Member State. The Commission argued that the Greek legislation did indeed result in higher taxation of the dividends paid from other Member States to Greek individuals.

In its response Greece argued that the individual recipients of inbound dividends are entitled to an ordinary tax credit, (i.e. tax paid abroad may be offset against the tax payable on foreign-source income) for any withholding tax effectively paid abroad. The Commission, however, argued that in fact the use of the credit method could result in even higher taxation, given the progressivity of the individual income taxation in Greece.

The Commission was not satisfied by the response of the Greek Government and referred the case to the ECJ.⁷

2.2.2 The question referred

On 4 September 2007, an action was brought before the ECJ by the European Commission against Greece by which the Court is asked to hold that the Hellenic Republic is in breach of its obligations under Arts. 56 and 43 of the Treaty estab-

⁵ Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee "Dividend taxation of Individuals in the Internal Market", COM(2003)810 of 19/12/2003.

The report can be found at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0810:FIN:EN:PDF>.

⁶ See the relevant press release (IP/06/1410) at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1410&format=HTML&aged=0&language=en&guiLanguage=en>.

⁷ See the relevant press release (IP/07/1019) at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1019&format=HTML&aged=0&language=en&guiLanguage=en>.

lishing the European Community and Arts. 40 and 31 of the EEA Agreement, in applying a tax regime for dividends from abroad that is less favourable than the regime for domestic dividends.⁸

2.3 Analysis

In the analysis that follows the free movement of capital will be checked first, as indicated by the question referred by the Commission and the freedom of establishment issues will be dealt afterwards. The Court is likely to invert the order of examination and examine the freedom of establishment first and subsequently to the free movement of capital.

2.3.1 Which freedom applies?

It is established case law that in answering the question whether national legislation falls within the scope of one or other of the freedoms of movement, the purpose of the legislation concerned must be taken into consideration.⁹

Similar to the situation in *Holböck*, the Greek legislation at stake is not intended to apply only to those shareholdings that enable the holder to have a definite influence on a company's decisions and to determine its activities.¹⁰ National legislation that makes the receipt of dividends liable to tax depending on the whether the source of those dividends is national or otherwise, irrespective of the extent of the holding which the shareholder has in the company making the distribution, may fall within the scope of both Art. 56 EC on the free movement of capital and Art. 43 on the freedom of establishment.¹¹

2.3.1.1 Free movement of capital

2.3.1.1.1 The application to EU Member States and EFTA States

The Commission argues that the Greek legislation constitutes a violation of the free movement of capital and, consequently, a violation of Art. 56 EC. According to Art. 56 EC, "all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited".

The concept of "movement of capital" covered by this article is not defined in the EC Treaty itself. For the definition of the movements of capital that fall under

⁸ The reference is published in OJ C 269 of 10-11-2007, p. 34.

⁹ ECJ 12 September 2006, C-196/04, *Cadbury Schweppes* [2006] ECR I-7995, paras. 31 to 33; 3 October 2006, C-452/04, *Fidium Finanz* [2006] ECR I-9521, paras. 34 and 44 to 49; 12 December 2006, C-374/04, *ACT Group Litigation* [2006] ECR I-11673, paras. 37 and 38, 12 December 2006, C-446/04, *FII Group Litigation* [2006] ECR I-11753, paras. 36 and 13 March 2007, C-524/04, *Thin Cap Group Litigation* [2007] ECR I-11753, paras. 26 to 34.

¹⁰ ECJ 24 May 2007, C-157/05, *Holböck* [2007] ECR I-4051, paras. 23-24.

¹¹ C-157/05, *Holböck*, para. 24; C-374/04, *ACT Group Litigation*, paras. 37 and 38 and C-446/04, *FII Group Litigation*, paras. 36, 80 and 142.

the scope of Art. 56 EC Treaty, reference should be made to the nomenclature contained in Annex I to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Art. 67 of the EEC Treaty, which also applies for the interpretation of current Art. 56 EC. The last paragraph of the introduction to Annex I states that the list of capital movements is not exhaustive.

The receipt of dividends is not expressly mentioned in Annex I to Council Directive 88/361/EEC. However, as already accepted by the ECJ, the receipt of dividends necessarily presupposes participation in a new or existing undertaking that is referred to in the nomenclature of Annex I to the Council Directive (Heading I (2) or it may fall under Heading III. A (2) of the same nomenclature, which refers to "acquisition by residents of foreign securities dealt in on a stock exchange". The ECJ held that the receipt by a national of a Member State residing in that Member State of dividends on shares in a company whose seat is in another Member State is covered by Directive 88/361/EEC.¹² Therefore, the Greek tax law provisions under scrutiny must be checked against the provisions of the free movement of capital of the EC Treaty.

2.3.1.1.2 The application to third countries

The protection of the free capital movements applies equally not only to capital movements between Member States but also to capital movements between a Member State and a non-Member State (third country). The application of the free movement of capital as far as third countries are involved is, however, subject to an important limitation: according to the stand-still provision of Art. 57 para. 1 EC, any restrictions on the free movement of capital that existed on 31 December 1993, under national or Community law, may continue to exist.

The ECJ has provided guidance as to when a national measure must be considered as "existing" for the purpose of application of Art. 57 para. 1 EC. The Court has held¹³ that any national measure adopted after 31 December 1993 is not, by that fact alone, automatically excluded by the derogation laid down in Art. 57 para. 1 EC. A provision which is, in substance, identical to the previous legislation will be covered by the derogation. By contrast, legislation based on an approach that differs from that of the previous law and establishes new procedures cannot be treated as legislation existing at the date fixed by Art. 57 para. 1 EC.

As far as the Greek tax rules are concerned, the provisions for the taxation of dividend income of individuals are to be found in the Income Tax Code, which was enacted in September 1994, well after the stand-still date fixed in Art. 57 para. 1 EC. However, the provisions contained in the codification of 1994 reflect substantially similar if not identical provisions that existed on 31 December 1993. In particular,

¹² ECJ 6 June 2000, C-35/98, *Verkooijen* [2000] ECR I-4073 paras. 28–30.

¹³ C-157/05, *Holböck*, para. 41.

- Art. 24 of the Income Tax Code now in force is identical to Art. 25 of Act No. 3323/1955 “on individual income tax”, which is one of the laws included in the codification of 1994; and
- Art. 114 para. 1 of the Income Tax Code now in force, providing for the exemption of domestic dividends, was already enacted in 1992 and constituted former Art. 14 of Legislative decree 3843/1958 “on corporate income tax”, which is another instrument included in the 1994 codification.

Furthermore, according to the Income Tax Code, the date of entry into force of the above-mentioned provisions is the date of the entry into force of the respective codified instruments of which those provisions were part, i.e. 1955 for the provisions under scrutiny.

2.3.1.2 Freedom of establishment

The freedom of establishment, provided for in Art. 43 EC, secures freedom of establishment for nationals of a Member State on the territory of another Member State. The freedom of establishment creates different obligations of a Member State, depending on the case and on whether that particular Member State is at any given time the host state or the origin state. In the case of a host state, the freedom of establishment includes the right of a national of a Member State to take up and pursue activities as self-employed person and to manage undertakings under the conditions laid down by the host state for its own nationals.¹⁴ In the case of the origin state, the freedom of establishment prohibits legislation of a Member State that hinders the establishment in another Member State of one of its nationals or of a company incorporated under its legislation.¹⁵

In accordance with settled ECJ case law, national provisions that apply to holdings by nationals of the Member State concerned in the capital of a company established in another Member State, giving them definite influence on the company’s decisions and allowing them to determine its activities, come within the substantive scope of the provisions of the Treaty on freedom of establishment.¹⁶ In such a case, if that same legislation has restrictive effects on the free movement of capital, such effects are an unavoidable consequence of any restriction on the freedom of establishment and do not justify, in any event, an independent examination of that legislation in the light of Art. 56 EC on the free movement of capital.¹⁷ Still, in situations where the dividend is received from a shareholding where “definite

¹⁴ C-157/05, *Holböck*, para. 26; ECJ 13 April 2000, C-251/98, *Baars* [2000] ECR I-2787, para. 27 and 11 March 2004, C-9/02, *de Lasteyrie du Saillant* [2004] ECR I-2409, para. 40.

¹⁵ C-157/05, *Holböck*, para. 27, 13 December 2005, C-446/03, *Marks & Spencer* [2005] ECR I-10837, para. 31 and C-196/04, *Cadbury Schweppes*, para. 42.

¹⁶ C-196/04, *Cadbury Schweppes*, para. 31, C-251/98, *Baars*, para. 22 and ECJ 21 November 2002, C-436/00, *X and Y* [2002] ECR I-10829, para. 37.

¹⁷ C-196/04, *Cadbury Schweppes*, para. 33 and ECJ 10 October 2004 C-36/02, *Omega* [2004] ECR I-9609, para. 27.

influence/control" does not exist (portfolio shareholding), the free movement of capital applies.

Furthermore, as far as third countries are concerned, it must be pointed out that the Chapter of the EC Treaty concerning the right of establishment does not include any provision extending its application to situations which involve the establishment in a non-Member State of a national of a Member State,¹⁸ and therefore the provisions relating to the freedom of establishment may not be invoked in situations of a substantial holding of a Greek tax resident in a company established in a third country.

Therefore, in the case of Greek tax residents that hold substantial shareholding in companies established in other Member States that affords them the possibility of exercising a manifest influence on the decisions of the undertaking and determining its activities, the Greek tax rules under scrutiny must be tested against the right of establishment provided for by the EC Treaty.

2.3.2 Discrimination or restriction?

In examining whether a domestic provision infringes the fundamental freedoms, the Court has developed two techniques: the discrimination approach and the restriction approach. Historically the discrimination approach was the first to appear in the reasoning of the ECJ case law; later on, the Court moved to the restriction approach. Nowadays this distinction is not followed by the Court. There is a difference between discrimination and restrictions. In the case of discrimination the national rule results in distinguishing, either overtly or covertly, between domestic and foreign economic operators or goods. In the case of restrictions the national rule is a rule that applies indiscriminately to both domestic and cross-border situations, but has the effect of hindering cross-border situations.¹⁹

In direct tax matters discrimination usually occurs in respect of foreign-source (inbound) income that is not taxed in the same way as domestic income whereas restrictions (measures without distinction) are usually caused by origin state rules, hindering the cross-border situation as compared to a similar purely domestic one. Discriminatory tax measures can only be justified by public interests listed in the EC Treaty itself²⁰ whereas restrictive measures can be justified by applying the rule of reason that has been developed through the ECJ case law.²¹

For the ECJ case law, however, the two approaches do not lead to any material differences; in fact, it appears that the restriction approach is just a shortened means of identifying an infringement.²²

¹⁸ C-157/05, *Holböck*, paras. 28–29.

¹⁹ Terra/Wattel, *European Tax Law*⁵ (2008), p. 53.

²⁰ See e.g. ECJ 29 April 1999, C-311/97, *Royal Bank of Scotland* [1999] ECR I-2651, para. 32.

²¹ Terra/Wattel, p. 55.

²² Schuch in Lang (ed.) *Direct Taxation: Recent ECJ Developments* (2003), p. 143; similarly, Wattel points out that the Court has not been very consistent in applying the distinction between discriminatory and restrictive measures (op.cit. p. 55).

2.3.2.1 *Is there discrimination?*

Under the discrimination approach, it first has to be ascertained whether two comparable situations are treated differently under the laws of a Member State. The Court has held that the application of different rules on similar situations or the application of the same rule on different situation constitutes discrimination.²³

It is obvious from the analysis of the Greek system above that from the perspective of the recipient of the dividend different rules apply to dividends of Greek source compared to dividends of foreign source: full relief from economic double taxation in the first case – no exemption from economic double taxation in the second case.

First of all, it is undisputed that it is for each Member State to organize its system for taxing distributed profits and in particular to define the tax base and the tax rate that apply to the shareholder receiving the dividend, in so far as these shareholders are liable to tax in that Member State. However, in structuring their tax system and in particular when they establish a mechanism for preventing or mitigating economic double taxation, Member States must comply with the requirements of Community law and especially those imposed by the Treaty provisions on free movement.²⁴

It is clear from the Court's case law that whatever the mechanism adopted for preventing or mitigating economic double taxation, the freedoms of movement guaranteed by the Treaty preclude a Member State treating foreign-sourced dividends less favourably than domestic-source dividends, unless such a difference in treatment concerns situations that are not objectively comparable or are justified by overriding reasons in the general interest.²⁵

The problem with the Greek tax system is that there is a mechanism for the prevention or elimination of economic double taxation on domestic dividends whereas no such mechanism exists for foreign-source dividends; this is a clear difference in treatment, resulting in more burdensome taxation for foreign-source dividends. The question is therefore whether under the Greek tax system the case of resident shareholders receiving dividends from resident companies is similar to the case of resident shareholders receiving dividends from non-resident companies.

The ECJ has already ruled that in the context of a tax rule that seeks to prevent or to mitigate the taxation of distributed profits, the situation of a shareholder receiving foreign-source dividends is comparable to that of a shareholder receiving

²³ See, for example, C-251/1998 *Baars*, para. 30; ECJ 27 June 1996, C-107/94, *Asscher* [1996] ECR I-3089 para. 40; 11 August 1995, C-80/94, *Wielockx* [1995] ECR I-2493, para. 17; 14 February 1995, C-279/93, *Schumacker* [1995] ECR I-225, para. 30.

²⁴ See C-446/04, *FII Group Litigation*, paras. 45 and 47.

²⁵ C-446/04, *FII Group Litigation*, para. 46; ECJ 15 July 2004, C-315/02, *Lenz* [2004] ECR I-7063, paras. 20 to 49; 7 September 2004, C-319/02, *Manninen* [2004] ECR I-7477, paras. 20 to 55.

domestic-source dividends in so far as, in each case, the profits made are, in principle, liable to be subject to a series of charges to tax.²⁶

This was made even clearer in the Court's decision on the *ACT* case²⁷ where it held that "where a Member State has a system for preventing or mitigating a series of charges to tax or economic double taxation for dividends paid to residents by resident companies, it must treat dividends paid to residents by non-resident companies in the same way. Under such systems, the situation of shareholders resident in a Member State and receiving dividends from a company established in that State is comparable to that of shareholders who are resident in that State and receive dividends from a company established in another Member State, inasmuch as both the dividends deriving from a national source and those deriving from a foreign source may be subject, first, in the case of corporate shareholders, to a series of charges to tax and, secondly, in the case of ultimate shareholders, to economic double taxation".

Therefore, under the Greek system, the situation of a Greek resident receiving foreign-source dividends is comparable to that of a Greek resident receiving national-source dividends and therefore the different/unequal treatment of those two situations constitutes discrimination that is in principle not in accordance with the EC Treaty provisions on the freedoms of movement.

2.3.2.2 Is there a restriction?

Since the Court in its recent case law follows the restriction approach, the case will also be analysed following the restriction approach developed by the Court.

Under the restriction approach, in order to establish an infringement of the Treaty freedoms it is enough to ascertain whether the national rule hinders a taxpayer from making use of the Treaty freedoms or making it less attractive for him.²⁸

It is established case law that such a difference in treatment as the one resulting from the application of the Greek tax rules has the effect of discouraging Greek resident taxpayers from investing their capital in companies established in other Member States. In addition, it also has a restrictive effect as regards companies established in other states in that it constitutes an obstacle to the raising of capital in Greece. Moreover, in so far as income arising from foreign-source capital is treated less favourably from a tax point of view than dividends paid by companies established in Greece, shares in companies established in other states are less attractive to Greek resident investors than those of companies having their seat in Greece.²⁹

²⁶ C-446/04, *FII Group Litigation*, para. 62.

²⁷ C-374/04, *ACT Group Litigation*, paras. 55–56.

²⁸ C-315/02, *Lenz*, paras. 20–21; C-35/98, *Verkooijen*, paras. 34–36; C-157/05, *Holböck*, para. 30; C-319/02, *Manninen*, para. 23.

²⁹ C-35/98, *Verkooijen*, paras. 34–35, C-315/02, *Lenz*, paras. 20–21, C-319/02, *Manninen*, paras. 22–23, C-446/04, *FII Group Litigation*, paras. 63–64.

Consequently, the discriminatory tax treatment of inbound dividends in Greece also constitutes a restriction on the free movement of capital or the freedom of establishment, depending on the case and the amount of shareholding giving rise to the dividend income.

2.3.2.3 *The case of the UK and effect of the Greece-UK DTC*

The DTC with the UK provides for the elimination of international economic double taxation by granting the right to credit the underlying tax pro rata (that is, the UK corporate tax) that has burdened the dividend received by the Greek resident.³⁰ This system is very close to an imputation system, according to the classification followed in the Commission report on dividend taxation of individuals in the Internal Market.³¹

Two further questions may arise with regard to that provision: the first one is whether the existence of such a provision in the DTC with the UK would oblige Greece to extend the same advantage to all its treaty partners within the EU (a); the second one is whether the credit method that is provided for in the Greece-UK DTC is in itself discriminatory as compared to the exemption method that is applied for the relief of domestic dividends from double economic taxation (b).

- a) **MFN issues:** As far as the first issue is concerned, it is sufficient to note that the issue is essentially a “most-favoured-nation” issue that has already been rejected by the ECJ. The Court has held³² that a function of DTCs is in principle to avoid the same income and assets being taxed in both states and to allocate powers of taxation between those two Member States that are parties to the DTC. The fact that those reciprocal rights and obligations apply only to persons resident in one of the two contracting Member States is an inherent consequence of bilateral double taxation conventions. As a result, a rule such as that laid down in Art. XIV of the Greece-UK DTC cannot be regarded as a

³⁰ Art. XIV para. 3 of Greece-UK DTC reads as follows: “(3) *Subject to the provisions of the law of Greece regarding the allowance as a credit against Greek tax of tax payable in a territory outside Greece, United Kingdom tax payable, whether directly or by deduction, in respect of income from sources in the United Kingdom shall be allowed as a credit against any Greek tax payable in respect of that income. Where such income is an ordinary dividend paid by a company resident in the United Kingdom, the credit shall take into account, in addition to the United Kingdom tax appropriate to the dividend, the United Kingdom tax payable by the company on the corresponding part of its profits; and, where it is a dividend paid on participating preference shares and representing both a dividend at the fixed rate to which the shares are entitled and an additional participation in profits, the United Kingdom tax so payable shall likewise be taken into account in so far as the dividend exceeds that fixed rate: provided that the amount of the credit shall not exceed the amount of the Greek tax charged in respect of that income.*”

³¹ See COM(2003) 810 final of 19-12-2003, p. 6.

³² ECJ 5 July 2005, C-376/03, *D* [2005] ECR I-5821, paras. 60-62; C-374/04, *ACT Group Litigation*, paras. 88 and 91.

benefit separable from the remainder of the Convention, but is an integral part thereof and contributes to its overall balance.

Therefore, the provisions of the Greece-UK DTC according to which an underlying tax credit is granted to UK dividends received by a Greek resident whereas no such tax credit is granted to dividends of companies of other Member States do not infringe the Treaty freedoms.³³

- b) **Imputation vs. exemption:** As far as the second issue is concerned, the ECJ had the opportunity to clarify recently that the choice by a Member State of an imputation system for the relief of double economic taxation of foreign-source dividends whereas the same Member State applies the exemption for the relief of double economic taxation of domestic-source dividends is not in principle prohibited by Community law.³⁴ However, the imputation system must possess certain characteristics in order to be compatible with Community law.

First of all, the UK-source dividends must not be subject in Greece to a higher rate of tax than the rate that applies to domestic-source dividends. Secondly, Greece must prevent UK-source dividends from being liable to a series of charges to tax by offsetting the amount of tax paid by the UK company making the distribution against the amount of tax for which the recipient of the dividend is liable, up to the amount of the latter amount.³⁵

Whereas the second condition is satisfied by the DTC provision under examination, it seems that the first one is not satisfied. Since the provision of the DTC is complementary to the Greek tax legislation, the taxation of the UK-source dividend is still governed in principle by the domestic rules, providing taxation at the progressive marginal rate of 40%, whereas Greek-source dividends are exempt from tax. And even though Community rules do not oblige Greece to repay the difference between the income tax rates that apply in Greece and in the UK,³⁶ Greece is still hindered by Community law from applying a higher tax rate for UK dividends than the tax rates that apply for domestic dividends.

The higher tax rate to which UK dividends are subject to in Greece has the result that, even though double economic taxation may be relieved, double juridical taxation may not always be relieved,³⁷ whereas double juridical taxation of domestic dividends is always relieved. Consequently, the DTC rule providing for the tax credits in Greece on UK dividends is not sufficient to make the Greek system compatible with Community law.

³³ C-374/04, *ACT Group Litigation*, para. 92.

³⁴ C-446/04, *FII Group Litigation*, paras 47–48.

³⁵ C-446/04, *FII Group Litigation*, paras. 49–50.

³⁶ C-446/04, *FII Group Litigation*, para. 52.

³⁷ This would be the case where there is no withholding tax on the dividend in the UK or where the withholding tax is less than the marginal applicable rate on the dividend in Greece.

2.3.3 Are the discrimination and/or the restriction justified?

Since it is established that the Greek rules constitute discrimination and create restrictions of the Treaty freedoms, it must be checked whether this discrimination and restrictions are or may be justified. National measures that are discriminatory may, in principle, only be justified by an exception or reason that is expressly stated in the Treaty itself whereas restrictive measures may also be justified by other grounds of justification that are not provided for by the Treaty but which have been recognized by the Court and accepted by it as overriding requirements in the general interest.

Although in principle different justification methods apply depending on whether a measure is discriminatory or restrictive, the Court's case law has not been clear on this issue.³⁸

We tend to agree with the opinion that it is not proper to draw a rigid distinction between the grounds of justification for discriminatory and non-discriminatory measures.³⁹ The analysis should therefore be based on whether the ground invoked is a legitimate aim of general interest and if so whether the restriction can properly be justified under the principle of proportionality.

Many possible justifications have been brought before the Court in order to save national measures found to be discriminatory or to have a restrictive effect.

In this part of the paper several such justifications are discussed as they may possibly be invoked by the Greek government before the Court, without, however, much hope for success, as the established ECJ case law shows.

2.3.3.1 *The national rules fall under the scope of Art. 58(1) EC Treaty*

It is true that according to Art. 58 para. 1 EC "the provisions of Article 56 shall be without prejudice to the right of Member States (a) 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 and (b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security". This right is restricted by Art. 58 para. 3 EC, according to which: "the measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56 EC Treaty".

³⁸ See the analysis of Advocate General Jacobs of 21 March 2002 Opinion on C-136/00, *Danner* [2002] ECR I-8147, points 34 et seq.

³⁹ See the analysis of Advocate General Jacobs of 21 March 2002 Opinion on C-136/00, *Danner*, points 40–41.

Based on these provisions the Greek government could possibly argue that a legislative provision such as those at issue here which, for the purpose of exempting dividends, draws a distinction between taxpayers who are not in the same situation with regard to the place where their capital is invested is not contrary to Community law. However, the possibility granted to the Member States of applying the relevant provisions of their tax legislation which distinguish between taxpayers according to their place of residence or the place where their capital is invested has already been upheld by the Court.⁴⁰

Consequently, the Greek government cannot rely on Art. 58 EC in order to justify the discriminatory legislation concerning the inbound dividends.

2.3.3.2 The need to preserve the cohesion of the national tax system

It could be argued that the Greek legislation is objectively justified by the need to ensure the cohesion of the national tax system. This argument has been accepted in the past by the Court⁴¹ in cases where a direct link existed in the case of one and the same taxpayer between the grant of a tax advantage and the offsetting of that advantage by a fiscal levy, both of which related to the same tax. This in the case with the Greek legislation: apart from the fact that it concerns two different taxpayers (the company paying the dividend and the individual shareholder receiving the dividend) and two different taxes (tax on the profits of the company and individual income tax) it is hard to find any advantage that the resident shareholder receiving foreign-source dividends enjoys under the Greek dividend taxation rules. Therefore, this argument cannot be upheld.⁴²

2.3.3.3 The intention to promote the economy of the country by encouraging investment by individuals in companies with their seat in Greece

Another possible justification would be the intention of the state to promote the Greek economy by encouraging investment by individuals in Greek companies. This argument, however, as well as any argument that involves aims of a purely economic nature, is rejected by the Court⁴³ and we see no special reason why it should be upheld in this case.

2.3.3.4 Reduction in the tax receipts – loss of revenue

It is true that ECJ decisions may have a huge impact on national budgets and therefore governments often invoke reduction in the tax receipts or the loss of

⁴⁰ C-35/98, *Verkooijen*, para. 43; C-319/02, *Manninen*, para. 36.

⁴¹ The fiscal coherence justification has been accepted by the Court in ECJ 28 January 1992, C-204/90, *Bachmann* [1992] ECR I-225 and 28 January 1992, C-300/90, *Commission v. Belgium* [1992] ECR I-305.

⁴² The cohesion argument was rejected on the same grounds in C-35/98, *Verkooijen*, paras. 56–58, C-315/02, *Lenz* para. 34 and C-319/02, *Manninen* para. 40, ECJ 23 April 2008, C-201/05, *CFC and Dividend Group Litigation*, para. 66.

⁴³ See e.g. C-35/98, *Verkooijen*, paras. 47–48, with further references to ECJ case law.

revenue as an overriding reason in the general interest to justify a restrictive measure. The Greek tax authorities are able to tax the companies based in Greece but they are not able to tax the companies that are resident in other Member States; consequently, the Greek tax authorities do not receive any tax on the profits of companies distributing dividends. The Court systematically rejects such arguments.⁴⁴

2.3.3.5 The need to prevent tax evasion and the risk of tax avoidance

It could be argued that since the Greek tax authorities are not always in a position to know how much or if any tax is levied by the source country on either the corporate profits of the company making the distribution or the income of the individual receiving the dividend, there may be cases where a dividend could totally escape taxation.

The argument of tax evasion is a justification that, under conditions, is upheld by the Court. According to the conditions laid down by case law, a measure that is designed to prevent tax evasion may not be a general one, it must be specifically targeted to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned and in any case it must be proportional.⁴⁵ The Greek rules under scrutiny are not specifically designed to combat tax avoidance, although one may suggest that by taxing the foreign-source dividends in Greece the possibility of tax evasion is indeed minimized. The specific provisions, however, have a far wider scope and therefore they cannot be justified.⁴⁶

2.3.3.6 The desire to offset a tax advantage enjoyed by the taxpayer in another country

It could be argued that the granting of an exemption to foreign-source dividends would enable Greek taxpayers receiving such dividends to enjoy tax reliefs both in the source state (where the dividend is paid) and in the residence state (where the dividend is received). However, an argument based on a possible tax advantage for Greek taxpayers receiving foreign-source dividends is not capable of justifying unfavourable tax treatment contrary to a fundamental freedom.⁴⁷

2.3.4 Procedural issues

From the analysis of the case it is clear that the question referred to the Court is similar to questions on which the Court has already ruled and the answer to such a question may be clearly deduced from existing case law (“acte clair”).

⁴⁴ See C-315/02, *Lenz*, para. 40, C-319/02, *Manninen*, para. 49, C-35/98, *Verkooijen*, para. 52.

⁴⁵ C-201/05, *CFC and Dividend Group Litigation*, para. 80; C-196/04, *Cadbury Schweppes*, para. 51, C-446/03, *Marks & Spencer*, para. 57.

⁴⁶ Similar arguments such as that of the effectiveness of fiscal supervision or other administrative difficulties have also been rejected by the Court; see especially C-315/02, *Lenz*, paras. 44 et seq. and C-319/02, *Manninen*, para. 54.

⁴⁷ C-35/98, *Verkooijen*, paras. 54 and 61 and the case law cited therein; C-315/02, *Lenz*, para. 43.

It is possible, therefore, that the Court may, after hearing the Advocate General, at any time give its decision by reasoned order in which reference is made to its previous judgment or to the relevant case law, according to the first subparagraph of Art. 104 para. 3 of the Rules of Procedure of the ECJ.⁴⁸

2.4 Conclusions – Effects of the judgment on the Greek system of inbound dividend taxation

The Commission report on the dividend taxation of individuals in the internal market is very clear on this issue: Member States which exempt all or part of the domestic dividends should extend this exemption to inbound dividends.

The Greek parliament has recently enacted a new Act, according to which the existing legislation is amended: a final withholding tax of 10% is imposed on both domestic and inbound dividends. The 10% tax is withheld by the company making the distribution, or in the case of foreign companies, by the agent making the payment in Greece (usually a bank). The above provision is effective as from 1 January 2009 for dividends acquired as from 1 January 2009.

Under this new regime, the taxation of both domestic and inbound dividends in Greece has been made equal. *v. 3697/2008*

III. Taxation of foreign partnerships

The second set of rules that was the subject of the infringement procedure initiated by the European Commission are the rules relating to the taxation of the foreign partnerships that are established in Greece through a branch. In the following sections, after the presentation of the Greek legal background (2.1) and the details of the case brought before the Court (2.2) an analysis of the case will follow (2.3) and some final conclusions will be drawn as to the possible effects of the judgment on the Greek tax system (2.4).

3.1 The Greek legal background: taxation of partnerships

3.1.1 The taxation of Greek partnerships

Under Greek tax law, a partnership is a taxable entity in itself, separate from the members that participate in it.⁴⁹ Individuals and corporations as well as other partnerships may participate in a partnership. This fact can affect the taxation of the partnership's profits, as will be shown later.

⁴⁸ Text available at <http://curia.europa.eu/en/instit/txtdocfr/txtsenvigreur/txt5.pdf>.

⁴⁹ Until 1992 partnerships were treated as transparent entities for tax law purposes: their profits were taxed only at the level of the members of the partnership. This regime was changed by Act No. 2065/1992, which made partnerships fiscally opaque and established the current tax system, which, despite minor alterations over the years, has remained essentially the same as the one enacted in 1992.

Partnerships, according to Art. 2 para. 4 of Income Tax Code, are subject to individual income taxation. For the calculation of their profits the provisions of individual income taxation apply. The most important consequence of the application of the individual income taxation rules is that dividends of Greek corporations are excluded from the taxable base of the partnership.⁵⁰

The partnership's net profits are taxed at a flat rate of 20%.⁵¹ However, this is the case only when no individuals participate in the partnership. When individuals participate in a partnership, then the treatment is different. In the latter case a part of the profits of the partnership is taxed at the level of the individual partners, as part of a partner's aggregate taxable income, following the progressive tax rates used for individuals (highest marginal tax rate 40%). This part of the profits is called "*business remuneration*" of the individual partner and is calculated on the basis of the following rules:

- business remuneration can be calculated for up to three individual partners;
- in case there are more than three individual partners, then business remuneration is attributed to the three partners with the higher participation shares;
- the business remuneration is calculated on the 50% of the total net profit of the partnership;
- the amount attributed to each eligible partner is equal to his share in the participation.

The business remuneration that is attributed to the individual partners is exempt from the taxable profits of the partnerships and the remaining is taxed at 20%.⁵²

Two examples will better illustrate the application of those rules:

A) A partnership has the following partners:

- Mr. A – 10%
- Mr. B – 15%
- Mr. C – 5%
- Mr. D – 10%
- A Corp. – 25%
- B Corp. – 35%

Assuming that this partnership has a profit of 100 in fiscal year 2007, it will be taxed as follows:

Total profit: 100

Less business remuneration of Mr. B $(100 \times 50/100) \times 15/100 = 7.5$

Less business remuneration for Mr. A $(100 \times 50/100) \times 10/100 = 5$

Less business remuneration for Mr. D $(100 \times 50/100) \times 10/100 = 5$

⁵⁰ Art. 10 para. 1 third paragraph Income Tax Code.

⁵¹ Art. 10 para. 1a Income Tax Code.

⁵² Art. 10 para. 1 fourth para. Income Tax Code.

Taxable partnership profit: 82.5

Total amount of profits that are taxed based on the progressive income tax rates: 17.5

Total partnership income tax: 16.5

Total individual income tax (assuming 40%): 7

Combined tax on the partnerships profits: 23.

B) Another partnership has the following partners:

- Mr. A – 40%
- Mr. B – 30%
- Mr. C – 30%

Assuming that this partnership has a profit of 100 in fiscal year 2007, it will be taxed as follows:

Total profit: 100

Less business remuneration of Mr. A $(100 \times 50/100) \times 40/100 = 20$

Less business remuneration for Mr. B $(100 \times 50/100) \times 30/100 = 15$

Less business remuneration for Mr. C $(100 \times 50/100) \times 30/100 = 15$

Taxable partnership profit: 50

Total amount of profits that are taxed based on the progressive income tax rates: 50

Total partnership income tax (20%): 10

Total individual income tax (assuming 40%): 20

Combined tax on the partnerships profits: 30.

Depending on the aggregate taxable income of the individuals-partners, the tax burden may vary from 0 up to 40%. The tax paid on the business remuneration of the individual partners relieves the profits of the partnership from any further taxation. The profits distributed by the partnership are not taxed again.

3.1.2 The taxation of foreign partnerships established in Greece

According to the Greek Income Tax Code, “foreign undertakings, whatever the form of company under which they operate, and all types of foreign organizations seeking to make financial profit” are subject to corporate income tax.⁵³ This article covers, among other cases, foreign partnerships operating in Greece through a branch. The tax is payable on the total net income, from whatever source⁵⁴ earned by the legal persons referred to in Art. 101, where foreign undertakings are included. This has three important consequences that differentiate the tax treatment of foreign partnerships operating in Greece from the tax treatment of Greek partnerships:

⁵³ Art. 101 para. 1d Income Tax Code.

⁵⁴ Art. 98 Income Tax Code.

- the provisions on the deduction of an amount as business remuneration do not apply to branches of foreign partnerships;
- the aggregate profits of the foreign partnership are taxed at a flat rate of 25% (the standard corporate income tax rate); and
- the dividends received from Greek companies are not exempt but form part of the taxable base of the foreign partnership, thus granting no relief for economic double taxation on domestic dividends.

The combined effect of those elements of the taxation of foreign partnerships in Greece makes their taxation more burdensome as compared to Greek partnerships in at least two aspects: the applicable tax rate and the applicable rules for the taxable profits.

3.2 The case brought before the ECJ by the Commission

3.2.1 Background to the infringement procedure

On 3 January 2007, the European Commission sent a formal request to Greece in the form of a “reasoned opinion” under Art. 26 of the EC Treaty, to end discrimination of non-Greek partnerships.⁵⁵ The European Commission requested Greece to amend its legislation concerning the tax rules according to which non-resident partnerships in Greece are taxed more heavily than Greek resident partnerships. The Commission’s request was focused on the fact that the tax rate applicable to foreign partnerships is higher than the tax rate applicable to domestic partnerships.

Greece replied, acknowledging the difference in the applicable tax rates but argued that it is justified, since a proportion of the profits of a domestic partnership is taxed in the hands of the individual partners. The Commission was not satisfied by this answer, since, as we already demonstrated, this may result in effect in an even lower taxation than the 25% applied to foreign partnerships.

Moreover, Greece argued that no foreign partnership has ever complained about discriminatory tax treatment and that from the data available it appeared that no foreign partnership was operating in Greece under a branch. The Commission regarded those arguments as irrelevant. We will return to them later on, in the section on possible justifications.

Since Greece did not provide an adequate justification nor did it amend its tax rules within the term prescribed by the Commission, the European Commission decided in July 2007 to refer Greece to the ECJ.⁵⁶

⁵⁵ IP/07/14 available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/14&format=HTML&aged=0&language=en&guiLanguage=en>

⁵⁶ IP/07/1018 available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1018&format=HTML&aged=0&language=en&guiLanguage=en>

3.2.2 The question referred

On 4 September 2007, an action was brought before the ECJ by the European Commission against Greece by which the Court is asked to declare that the Hellenic Republic is in breach of its obligations under Art. 43 of the Treaty establishing the European Community and Art. 31 of the EEA Agreement, in maintaining in force the provisions of the Income Tax Code, by which foreign partnerships in Greece are taxed more heavily than domestic partnerships.⁵⁷

3.3 Analysis

3.3.1 Which freedom applies?

According to the Commission, the Treaty freedom that is violated by the Greek tax rules is the freedom of establishment.

The freedom of establishment for nationals of one Member State on the territory of another Member State, as it has been interpreted by the case law of the ECJ, includes, among other things, the right to take up and manage undertakings under the conditions laid down for its own nationals by the law of the country where such establishment is effected (principle of national treatment). The abolition of restrictions on freedom of establishment also applies to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of another Member State.⁵⁸

Furthermore, as far as companies are concerned, it is now well established that it is the seat of the company that serves as the connecting factor with the legal system of a particular state, such as nationality in the case of natural persons.⁵⁹

In the case at hand, Greece acts as a host state and therefore, in principle, under Community law, it has to accord national treatment to foreign partnerships operating in Greece through a branch.

3.3.2 Comparability issues

It is settled case law that discrimination consists in the application of different rules to comparable situations or in the application of the same rule to different situations.⁶⁰

In order to determine whether a difference in treatment such the one resulting from the combined effect of the Greek corporate and individual income tax rules that apply to foreign and domestic partnerships operating in Greece, it is necessary to ascertain whether the two cases are comparable. In particular, it is necessary to

⁵⁷ The reference is published in OJ C 269 of 10-11-2007, p. 34.

⁵⁸ C-311/97, *Royal Bank of Scotland*, para. 22; ECJ 23 February 2006, C- 253/03, *CLT-UFA* [2006] ECR I-1831, para. 13.

⁵⁹ C-311/97, *Royal Bank of Scotland*, para. 23.

⁶⁰ C-311/97, *Royal Bank of Scotland*, para. 26.

ascertain whether for the purpose of the taxation of profits earned in Greece, a partnership having its seat in Greece and a branch established in Greece of a partnership having its seat in another Member State are in an objectively comparable situation.

In its case law the ECJ accepts the international tax law principle that the situations of residents and non-residents in a given state are not generally comparable.⁶¹ It is prepared, however, to accept cases where the situation of residents and non-residents are comparable, disregarding the fact that resident companies are subject to unlimited tax liability whereas non-resident companies are subject to limited tax liability. This fact cannot prevent the two categories of companies from being considered, all other things being equal, as being in a comparable situation with regard to the purpose of the rule that is being tested by the Court.

In the *Commission v. France (Avoir Fiscal)* case the Court held that the French legislation at issue did not distinguish in terms of taxation between companies whose registered office was in France and branches in France of companies whose registered office was in another Member State. As a result, France could not, without giving rise to discrimination, argue that these two types of taxpayers should be treated differently in regard to the grant of an advantage such as the *Avoir Fiscal*.⁶² This statement on comparability was further elaborated in subsequent ECJ decisions.

In the *Royal Bank of Scotland* case the Court found that the situation of a bank having its seat in Greece (resident bank) and the Greek branch of a bank having its seat in the UK (non-resident bank) are comparable. The criterion used for the comparison was the method of determining the taxable base. The Court accepted that "as far as the method of determining the taxable base is concerned, the Greek tax legislation does not establish, as between companies having their seat in Greece and companies which, whilst having their seat in another Member State, have a permanent establishment in Greece, any distinction such as to justify a difference of treatment between the two categories of companies".⁶³

In its *CLT-UFA* decision the Court used the same criterion to make the comparison between the situation of residents and of non-residents: the method for determining the taxable amount. In particular, the Court held that "the national legislation on the manner of determining the taxable amount does not draw a distinction between companies with their seat in another Member State, according to whether they pursue their activities through a branch or a subsidiary, which is capable of justifying a difference in treatment between the two categories of companies".⁶⁴

⁶¹ C-311/97, *Royal Bank of Scotland*, para. 27.

⁶² ECJ 28 January 1986, Case 270/83, *Commission v. France (Avoir Fiscal)* [1986] ECR I-273, para. 20.

⁶³ C-311/97, *Royal Bank of Scotland*, para. 28.

⁶⁴ C-253/03, *CLT-UFA*, para. 29.

The problem with the issue at hand is that it does not satisfy the criterion set by established case law for determining the comparability of the situation of the two taxpayers: according to Greek income tax legislation, the method for determining the taxable amount is different for domestic partnerships than the method used for the determination of taxable profits of branches of foreign partnerships. The differentiation arises from the fact that domestic partnerships fall within the scope of individual income taxation whereas branches of foreign partnerships operating in Greece fall within the scope of corporate taxation. It is clear that under the Greek tax rules domestic partnerships are not considered to be in the same situation as foreign partnerships, as far as the determination of the taxable base is concerned.

This choice seems as ludicrous as the hypothetical choice of a state to treat a foreign individual's permanent establishment in that state as a subsidiary, thus paying corporate tax, rather than as an individual paying his personal income tax rate on the profits of the PE.⁶⁵ This choice seems to be (at least *prima facie*) a political choice of the Member State concerned (in this case: Greece). The question therefore is whether such a choice is consistent with Greece's obligations arising from Community law.

It is well established case law that although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law and avoid any discrimination on grounds of nationality. How a state chooses to define the tax unit to which it then applies its national rules for computing tax liabilities is another aspect of its exercising its taxing powers and therefore not within the Community competence.⁶⁶ In the present case Greece has decided to make branches of foreign partnerships subject to corporate tax, assimilating them, from an income tax law point of view, to Greek corporations and treating them as taxable entities and not transparent entities.

This choice is not a strange one; partnerships are not treated in the same way in all the jurisdictions that recognize them. In some cases they are treated as transparent entities, in other jurisdictions they are treated as taxable units and in other cases, like in Greece, they are in an intermediary situation, where the partnership is partly treated as taxable unit and partly disregarded for tax purposes.

It appears that the ECJ's comparability criterion is difficult to fulfill. Furthermore, the fact that the personal circumstances of the partners-natural persons are taken into account in order to determine the tax of the partnership makes it even more difficult to establish comparability under Greek income tax law.

We think, however, that there may be some arguments that could speak in favour of comparability between domestic partnerships and Greek branches of partnerships established in another Member State.

⁶⁵ This example and the characterization belong to Lüdicke, in Lang, *ECJ – Recent Developments in Direct Taxation* (2006), p. 132.

⁶⁶ Gammie, The compatibility of national tax principles with the single market, in Vanistendael, *EU Freedoms and Taxation* (2006), p. 162.

First, there is a problem of an indirect non-recognition of the legal form under which the foreign partnership operates in its origin state. Although it is not a corporation, in Greece it will always be treated as a corporation, for tax purposes.

Second, the personal circumstances of individuals-partners of a foreign partnership are not taken into account in Greece. Therefore, the partners of the foreign partnership are also taxed more heavily in Greece and in that case their freedom of establishment would be restricted.

Third, the fact that the foreign partnership is taxed in Greece is enough to establish comparability with Greek partnerships. A foreign partnership established in Greece through a branch is subject to limited taxation on its net income in Greece and it is a taxable unit in itself for tax purposes. In the case of a domestic partnership with no natural persons as partners, the treatment is the same: all the partnership's net income is taxed at the hands of the partnership, making it thus a fully taxable unit, where no personal circumstances are taken into account. Both cases are comparable from a tax law point of view.

Fourth, it appears that the only reason that a foreign partnership is subject to different rules in Greece is the fact that it is a partnership that is not established in Greece. Acceptance of the proposition, however, that a Member State in which a foreign partnership seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its seat is situated in another Member State would deprive EC Treaty provisions on the freedom of establishment of all meaning.⁶⁷ The rules concern the exercise by Greece of its competence on direct taxation and in this case it may be argued that the exercise by Greece of its taxing power is not consistent with Community law.

Fifth, the distinction between individual and corporate tax rules is not relevant for the case. The comparison should be taken at the higher level of income taxation, without taking into account the particularities of the individual or corporate income taxation.

These arguments or a combination of them could lead the Court to establish comparability between a domestic partnership and a branch of a foreign partnership.

3.3.3 Discrimination or restriction?

Since we concluded that comparability may exist in this case, the question arises of whether the Greek rules result in discrimination or have a restrictive effect.⁶⁸

⁶⁷ C-311/97, *Royal Bank of Scotland*, para. 23.

⁶⁸ If comparability is not established between the situation of a domestic partnership and a Greek branch of a partnership established in another Member State, (since the Greek rules for the determination of the taxable income of each case are different), there can be no discrimination based on nationality created by the Greek rules: discrimination, according to the ECJ case law consists in the application of different rules to comparable situations or in the application of the same rule to different situations.

First, the criterion for the application of different rules to domestic and foreign partnerships operating through a branch in Greece is the seat of the partnership. The seat of the partnership is in this context the equivalent of nationality in the case of natural persons. Therefore, the application of a different (higher) tax rate on the profits of a branch of a foreign partnership constitutes discrimination prohibited by the EC Treaty.

Having established discrimination on grounds of nationality, the analysis should stop here. Since the Court applies its broader restriction approach when dealing with national measures that differentiate between purely domestic and cross-border situations, the analysis will follow by examining whether there is a restriction.

According to settled case law regarding the freedom of establishment, the higher tax rate applicable to branches of foreign partnerships in Greece renders the possibility, for partnerships having their seat in another Member State, of exercising the right of establishment through a branch less attractive. It follows that a national measure like the Greek one restricts the freedom to choose the appropriate legal form in which to pursue activities in another Member State.⁶⁹

3.3.4 Are discrimination and/or the restriction justified?

Greece has already put forward two arguments in order to justify the existing system. These arguments, along with some other possible justifications, will be analysed in the following paragraphs.

3.3.4.1 A proportion of the profits of Greek partnerships is taxed in Greece at the hands of the individual partners

This argument was put forward by the Greek government as a justification for the different treatment of foreign partnerships by the Greek legislation. This argument relates to the tax treatment of partnerships in Greece in which natural persons participate and is only valid under specific circumstances. A result of this system is that the partnership cannot be considered to be similar to a company and therefore the rules that apply to the freedom of establishment of companies do not apply in this case. The Commission regarded this argument as irrelevant and in fact it argues that this treatment may result in even lower taxation for domestic partnerships, rendering the argument incapable of justifying the different treatment.

3.3.4.2 No foreign partnerships operate in Greece in the form of a branch

The Commission also considered this argument to be irrelevant for the justification of the different treatment of foreign partnerships. This argument actually implies that no actual breach has taken place, since no branch of a foreign partnership has been subject to the different tax treatment provided for by the Greek rules.

⁶⁹ C-253/03, *CLT-UFA*, para. 17.

This argument, however, is not a valid justification, because according to ECJ case law a national measure need not be actually restrictive or disadvantageous but it is sufficient if it is found to be potentially⁷⁰ restrictive or disadvantageous. In other words, even if the measure has not had any practical effect the fact that it is liable⁷¹ to create a disadvantage or to restrict the Treaty freedoms is enough for the Court to establish discrimination or restriction that cannot be justified by the fact that the measure is not applied in practice.

3.3.4.3 The difference in the applicable tax rates is a very small one (only 5%)

This argument has not been upheld by the Court. In its judgment on the case *Commission v. France* the Court held that "Article 52 EC Treaty [now Art. 43] prohibits all discrimination, even if only of a limited nature".⁷² Therefore, no *de minimis* rule applies in the area of free movement of persons and consequently discriminatory or restrictive measures are not justified because their actual effect may be so small as to be negligible.⁷³

3.3.4.4 Administrative difficulties in the application of the system that applies to domestic partnerships and effectiveness of fiscal supervision

The Greek government may also argue that it is very difficult to apply the Greek system to foreign partnerships because that would create a huge administrative burden on the Greek tax authorities. ECJ case law, however, has rejected similar argumentation in the past, constantly referring Member States, when they raise the issue, to the Mutual Assistance Directive.⁷⁴

3.4 Conclusions – Effects of the judgment on the Greek tax system

In our view, the outcome of the decision will depend on the issue of comparability. Once comparability is established based on one of the alternative grounds presented in the analysis in the previous section, the different treatment of foreign partnerships will be very difficult to be justified.

Since indeed these rules have been used very little in practice, the immediate financial impact of a judgment will be minimal, if not zero. The Greek rules, of course, will have to be amended. So far, however, the Ministry has not published anything on its intention to change the current regime.

⁷⁰ Van Thiel, *Free Movement of Persons and Income Tax Law: The European Court in search of principals* (2002), p. 549 with reference to the *Biehl*, *Commerzbank*, *Schumacker* and *Asscher* case law.

⁷¹ ECJ 27 February 2002, C-480/01, *Commerzbank v. Commission* [2002] ECR I-2129, para. 15. (order)

⁷² Case 270/83, *Commission v. France (Avoir fiscal)*, para. 21.

⁷³ Van Thiel, p. 550.

⁷⁴ C-204/90, *Bachmann*, para. 18; ECJ 15 May 1995, C-250/95, *Futura Participations* [1997] ECR I-2471, para. 41.

In the recent Act amending various provisions of the Income Tax Code no provision addresses the issue in hand specifically. Discrimination against foreign partnerships is treated only indirectly: the new legislation provides for the gradual lowering of the tax rate of corporate taxation; under the new provisions, the tax rate for corporate income tax will be 20% in 2014, the same as the current income tax rate that applies for the taxation of the profits of domestic partnerships. Thus, in the long term the tax treatment of both domestic partnerships and branches of foreign partnerships will be the same. The different rules that apply as far as the calculation of their taxable profits is concerned remain.

IV. Concluding remarks

The reference to the ECJ seems to have mobilized the Greek government, at least as far as the inbound dividend taxation rules are concerned. The changes introduced by the recently enacted legislation are indeed addressing the issue in a seemingly adequate way. As far as the taxation of branches of non-Greek partnerships is concerned, it remains to be seen what the response of the Greek government will be, if any.