Belgium: the *Imfeld & Garcet* case and the *Levy* case

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1. Imfeld and Garcet (C-303/12)

The question referred in *Imfeld & Garcet* (C-303/12) concerns the attribution of personal allowances to a married couple of which one of the partners earns all his income outside his home State and that income accounts for more than half of the family income.

1.1. Facts and legislation

Mr Imfeld*,* a German national residing in Belgium with his Belgian spouse Mrs Garcet and their two children, derived his entire income from activities as a self-employed person (lawyer) in a German fixed base (law office, hereinafter "FB"). Mrs Garcet earned income from an employment activity carried on in Belgium. The German income was the sole income of Mr Imfeld and accounted for more than half of the family income.

The double tax convention between Germany and Belgium (hereinafter "DTC") provides that income derived by a Belgian resident from a liberal profession is taxable in the work State if the taxpayer has an FB in that State (Art. 14(1) DTC). It also provides that if income derived from German sources is taxable in Germany on the basis of the DTC (other than investment income), Belgium will exempt such income. This exemption, however, does not limit the right of Belgium to take into account this exempt income for the determination of the applicable tax rate to any other income that is taxable in Belgium (exemption with progression) (Art. 23 (2)(1) DTC).

The Belgian domestic rules on the exemption with progression provide for a proportional double tax relief of the foreign source income if it may be taxed under a DTC in the other State. In the first place, the tax is calculated on worldwide income and subsequently it is reduced by the ratio between the exempt foreign income and the worldwide income. In Belgium, married couples file a joint tax return, but the tax is calculated separately on the income of each partner. In case of a couple filing a joint return, the relief for foreign income is calculated separately per spouse on his/her total net income (Art. 155 ITC). In determining the personal and family allowances, the Belgian legislation takes into account dependent children by providing an increase of the tax-free bracket (Art. 132 ITC). In case of a couple filing a joint return, the tax-free bracket of the spouse who earned the highest amount of income is increased by these allowances (Art. 134 §1 (2) ITC). For taxpayers who have earned income from a professional activity carried out abroad and that is taxable abroad under a DTC, it is important to note that the granting of family allowances in combination with the proportional double tax relief under the exemption with progression is further detailed in Circular Ci.RH.331/575.420 of 12 March 2008, which was issued by the tax authorities to make the Belgian rules compliant with the *De Groot*-case law of the ECJ (see *infra*).

In the present case, the German income of Mr Imfeld is taxed in Germany in accordance with the DTC. In Germany he is treated as a single person and as a result he does not enjoy the *Ehegattensplitting* in Germany. However he was granted there an allowance for his dependent children. In Belgium, his German income is exempt with progression in accordance with Art. 155 ITC and the family allowances are granted in accordance with Art. 132 and Art. 134 ITC. Hence, the tax-free bracket of Mr Imfeld was increased by the allowance for dependent children as he earned a higher amount of income from professional activity than his wife. However, since Mr Imfeld's income taxable in Belgium only consisted of the German source income that was exempt in Belgium under the DTC, the increase of the tax-free bracket did not result in an effective material advantage for him. Further, Mr Imfeld was denied the benefit of the 2008 Circular because he enjoyed family allowances in the work State. The couple tried to overcome the denial of the family allowances in Belgium by having each partner file a separate tax return and having Mrs Garcet claim the allowance for dependent children. This was refused by the Belgian tax authorities. They required the filing of a joint return and allocated the family allowance to Mr Imfeld. The case is being litigated before the Tribunal of First Instance of Liège.

1.2. Alleged incompatibility and reference for a preliminary ruling

In the present case, the taxpayer argued that the joint application of Art. 134 and Art. 155 ITC results in a situation where not all the family and personal allowances are enjoyed in Belgium and that, accordingly, these rules are incompatible with the free movement of workers (Art. 39 EC).

The Tribunal of First Instance of Liège has therefore made the following reference for a preliminary ruling:

Is it contrary to Article 39 [EC] that, as a result of the provision made under the Belgian tax system, specifically under Article 155 of the 1992 Income Tax Code and the second subparagraph of Article 134(1) of that Code, and regardless of whether Circular No Ci.RH.331/575.420 of 12 March 2008 is applied, the income earned in Germany by the first applicant – which is exempt from tax [in Belgium] pursuant to Article 17 of the Convention concluded between Germany and Belgium for the avoidance of double taxation – is taken into account for the purposes of calculating the tax payable in Belgium and is used as the basis of assessment for the grant of tax advantages provided for under the 1992 Income Tax Code, and those advantages, such as the tax-free allowance because of the first applicant's family circumstances, are reduced or granted to a lesser extent than if the income of both applicants were earned in Belgium and if the higher income were that earned by the second applicant, rather than by the first applicant, whereas, in Germany, the income of the first applicant is taxed as though he were a single person and he is accordingly not entitled to all the tax advantages linked to his personal and family circumstances, of which the German tax authorities take account only in part?

As a preliminary remark we note that the reference for preliminary ruling wrongly refers to Art. 39 EC (Art. 45 TFEU). As Mr Imfeld is a self-employed lawyer, the relevant freedom is the freedom of establishment and the ECJ should correct this and analyze the question under the freedom of establishment (Art. 43 EC, Art. 49 TFEU).

1.3. Analysis

1.3.1. Applicability of *Schumacker* and *Gschwind*

This reference for a preliminary ruling fits within the broader framework of case law regarding personal and family allowances.[1] According to the case law of the ECJ, this case law should be equally applicable to employees and self-employed persons.[2]

The basic principle that follows from the above-mentioned case law is that residents and non-residents are, in principle, not in the same situation as regards personal and family tax allowances. The home State is considered to be in a better position to assess the taxpayer's overall ability to pay tax and should take into account his personal and family circumstances because that State is better informed about those circumstances of its residents than is the work State and because residents usually derive only part of their income from another Member State. Therefore, the work State is not required to extend to non-residents the personal and family allowances which it grants to residents.

An important exception to this rule is the situation where all or almost all income is derived from the work State ("*Schumacker* situations"). In that case, there is no objective difference between non-residents and residents earning employment income in the work State. To avoid discrimination the latter State is required to grant the same allowances to non-residents that it offers to residents.[3]

In the present case, Mr Imfeld had no income in his home State (Belgium), but his spouse earned Belgium source income from employment. In the *Gschwind* case, the ECJ had already decided that in such a case, the *Schumacker* doctrine does not apply.[4] The facts in the present case are highly comparable to those in *Gschwind*. In that case too one spouse earned work State income only, accounting for the major part of the family income, while the other spouse only earned home State income. The ECJ decided that the work State did not violate the free movement of workers

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1 ECJ 12 May 1998, C-336/96, *Gilly*; ECJ 14 February 1995, C-279/93, *Schumacker*; ECJ 14 September 1999, C-391/97, *Gschwind*; ECJ 12 December 2002, C-385/00, *De Groot*; ECJ 1 July 2004, C-169/03, *Wallentin*; ECJ 12 July 2005, C-403/03, *Schempp* and very recently ECJ 10 May 2012, C-39/10, *Commission vs. Estonia.*

2 ECJ 11 August 1995, C-80/94, *Wielockx.*

3 ECJ 14 February 1995, C-279/93, *Schumacker*, paras. 37, 38 and 47, confirmed recently in ECJ 10 May 2012, C-39/10, *Commission vs. Estonia*, para. 55 et seq.

4 ECJ 14 September 1999, C-391/97, *Gschwind*, para. 28, confirmed recently in ECJ 10 May 2012, C-39/10, *Commission vs. Estonia*, para. 54.

by refusing to grant personal and family allowances to the non-resident worker, because there was enough taxable base in the home State (the Netherlands) to absorb the allowances provided by that State. The Netherlands exemption with progression in combination with the attribution of family allowances works the same way as the Belgian rule. Because of the proportional calculation of the double tax relief, a taxpayer earning foreign source income forfeits part of the family allowances in the Netherlands. As a result, since only 42% of the family income was earned in the Netherlands, the couple was only granted 42% of the allowances and in the end, 58% of such allowances were lost.

An important difference between *Gschwind* and the present case is that *Gschwind* concerns litigation against the Work State, while Mr Imfeld is litigating against his home State. Furthermore, in the present case, there seems to be no discrimination. Belgium grants to Mr Imfeld the same amount of family allowances under the same conditions as to residents earning Belgian source income only. The theoretical outcome for both Mr Imfeld and Mrs Garcet would have been exactly the same as in a situation where Mr Imfeld earned the same amount of Belgian source income instead of German income. Since his income is higher than that of his spouse, the family allowances would have increased his tax-free bracket. Therefore, neither Mr Imfeld nor Mrs Garcet is discriminated against. There is, however, a practical difference, i.e. the allowances are not effectively enjoyed because they are attributed to exempt German income.

1.3.2. Applicability of *De Groot*

In the *De Groot* case, the ECJ decided that the free movement of workers precludes rules whereby a taxpayer forfeits, in the calculation of the income tax payable by him in the home State, part of the tax-free amount of that income and of his personal tax advantages because during the year in question, he also received income in another Member Sate which was taxed in that State without the personal and family circumstances being taken into account.[5] As a result of the *De Groot* judgment, from a technical perspective this means that the home State should allocate 100% of the personal and family allowances to the income earned domestically, even though not all income is derived from that State.

The question arises whether the ECJ's doctrine developed in *De Groot* is applicable in the present case. In *De Groot* the ECJ also decided that the home State may be released from its obligation to grant the allowances where specific rules are included in a DTC that impose an obligation on the work State to grant the allowances. Similarly, it is released from that obligation where the work State unilaterally (i.e. by virtue of its domestic law) grants personal and family allowances to non-residents receiving income in that State.[6] In the present case, the German

[5] ECJ 12 December 2002, C-385/00, *De Groot*, para. 110.

[6] ECJ 12 December 2002, C-385/00, *De Groot*, paras. 99–100.

taxpayer has effectively been granted allowances for his two dependent children in the work State Germany. Moreover, *De Groot* was a single taxpayer, who earned income in different States, including the home State, where he had enough income to effectively use the home State allowances. This is not the case in *Imfeld,* where the taxpayer did not earn any home State income.

Even if the ECJ's doctrine from *De Groot* applies, it is doubtful whether the taxpayer forfeits part of his tax-free amount in terms of the ECJ's decision in *De Groot*, since Mr Imfeld would be granted the same family allowances if he had earned the same amount of Belgian source income. His spouse too does not forfeit her advantages because if her husband had had the same amount of Belgian source income rather than German source income, the dependent children allowance would still have been granted to her husband and not to her because he earned the highest amount of income. Thus, it can be argued that the family allowances are granted in the same way as in purely domestic situations. Obviously they are not effectively enjoyed because Mr Imfeld only had exempt income in Belgium and the allowance was not carried over to his spouse. However, since Mr Imfeld was not taxed in Belgium, he did not suffer any disadvantage in Belgium. Arguably, there is no restriction of the freedom of establishment in his case.

1.3.3. Conclusion

On the basis of the above-mentioned case law, it is difficult to predict the exact outcome of the case, since it is not clear to what extent *De Groot* overrules *Gschwind* and to what extent these cases apply to different facts and different legal issues. It is therefore difficult to predict which of these cases one should apply in the present case.

On the one hand, the present case is a home State case while *Gschwind* was a work/source State case and it is difficult to judge what exactly could be learned from *Gschwind* for home State cases. Moreover, the outcome in *Gschwind* has to a certain extent been overruled by *De Groot*, in the sense that if allowances are not granted in the work State, the home State should allocate 100% of the allowances to the domestic income of the taxpayer. The result in *Gschwind* was that 58% of the allowances were forfeited. In the subsequent *De Groot* case the ECJ found this to be an unacceptable result.

However, on the other hand, the *De Groot* doctrine does not seem to be applicable in the present case because the work State already granted allowances for the dependent children to Mr Imfeld under the *Schumacker* doctrine (see paras. 99–100 of the *De Groot* judgment). Accordingly, the Belgian Circular of 2008 appropriately refuses a Belgian resident the benefit of the *De Groot* judgment if he has effectively enjoyed the family allowances in the work State. It is difficult to accept that the *De Groot* doctrine would require a home State to carry-over the unused family allowances to the spouse who did not exercise its freedoms, because her partner only derived exempt income from the work State. This would result in double ben-

efits: once in the work State for the partner who exercised his Treaty freedoms and once in the home State for the spouse who did not exercise any freedom. This is at odds with paras. 99–100 of the *De Groot* judgment and more generally with the "always somewhere but only once"- doctrine of the ECJ on the enjoyment of tax advantages.

Finally, the question arises whether Mr Imfeld should have litigated against the work State (Germany) rather than against his home State. Indeed, before the Belgian national court he complained that under German law he was taxed as a single person and as a result was denied the *Ehegattensplitting*. As this point seems to be a complaint about unequal treatment in the work Sate, it should be litigated there and is of no relevance for his treatment in the home State.

The reason why it is difficult to predict the outcome of this case is that the basic assumptions of the ECJ case law in matters of family allowances are not correct. The ECJ assumes that the home State is in a better position to assess a taxpayer's overall ability to pay tax since it has all necessary information readily available. However, by making use of the Mutual Assistance Directive or even by requesting information from the taxpayer itself, the work State could easily obtain the information needed. The ECJ further assumes that residents usually derive only part of their income from another Member State, while the ECJ's own case law shows that there are lots of situations where this is not the case. The ECJ also assumes that both States involved grant the same or comparable personal allowances, while practice shows that there are important differences between States. Moreover, the grant of personal and family allowances should always be seen in a broader context of taxation. Some States do not grant such allowances because they apply lower rates of taxation in the case of taxpayers with children. Also, the ECJ fails to correctly appreciate the full effect of the exemption with progression, i.e. the fact that, where a taxpayer earns foreign source income that is exempt in the home State in cases not covered by the *Schumacker* doctrine, part of the personal allowances are lost because they are inevitably attributed to exempt income (see e.g. *Gschwind*). And where the *Schumacker* doctrine applies and a taxpayer earns e.g. 90% of his income in the work State, why should the work State give 100% of the allowances and the home State still 10%, leading to a 110% benefit? A theoretically sounder solution is proposed by Wattel. He proposes that all States take into account worldwide income and tax this income *pro rata parte*, granting, also *pro rata parte*, the personal and family allowances and deductions.[7] We believe that such a system should at least be optional for taxpayers. Of course, the ECJ is unable to impose such a system and EU legislation is needed to this effect. In anticipation of this, nothing prevents EU Member States from providing for such a tax system bilaterally in their DTC (see e.g. Art. 26 (2) Belgium/Netherlands DTC, Art. 24 (4) Belgium/Luxembourg DTC).

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[7] B. Terra, P. Wattel, *European Taxation*, Kluwer Law International, 5th edition, 2007, pp. 793–806.