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PRACTITIONERS' CORNER

Trumping the Higher Court in Austria

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Higher court trumps lower court; that's the general rule. Similarly, in chess, although the queen is lower in rank, it can move further than the king. A move like that of a queen in chess was recently undertaken by an Austrian fiscal senate (comparable to a tax court) using the European preliminary ruling request procedure.

How to Trump a Higher Court

In April 2008 the Austrian Supreme Administrative Court (the highest tax court of Austria) ruled on a question related to Community law:[1] An Austrian corporation held less than 10 percent participations in foreign companies through a domestic investment fund. The dividends received through the investment fund were subject to taxation at the level of the Austrian corporation; had the dividends been paid by domestic companies, no taxation would have been triggered due to the participation exemption.

The local tax authorities disallowed an equal tax treatment of foreign and domestic dividends, while the independent fiscal senate called on in that case held that the statutory provision imposing taxation on foreign dividends had to be set aside by Community law. The fiscal senate applied the law as if the dividends were paid from a domestic company resulting in the exemption of the foreign dividends from taxation.[2]

Such holding, however, was overruled by the Austrian Supreme Administrative Court. Although the court agreed with the fiscal senate regarding the violation of Community law, it concluded that the legal consequences were different. The violation of Community law based on an infringement of the free movement of capital arose due to the unequal treatment of indirectly received dividends depending on whether they were paid by a domestic or a foreign corporation.[3] The Austrian Supreme Administrative Court did not follow the independent fiscal senate when it came to the extent by which the provision in question had to be set aside in order to be in line with the free movement of capital. Instead of merely setting aside the provision that imposed taxation on foreign dividends and applying the provision covering dividends from domestic corporations (applying an exemption from taxation), the Administrative Court held that a credit system had

[1]Austrian Supreme Administrative Court (Verwaltungsgerichtshof, or VwGH) (2008/15/0064), Apr. 17, 2008; *see also* Wimpissinger, ''Austrian Taxation of Dividends,'' *Tax Notes Int'l*, Sept. 22, 2008, p. 1039, *Doc 2008-18068*, or *2008 WTD 187-11*.

[2]Independent Fiscal Senate (Unabhängiger Finanzsenat, or UFS) (RV/0279-L/04), Jan. 13, 2005.

[3]Austrian Supreme Administrative Court (2008/15/0064), Apr. 17, 2008.

to be read into the law[4] according to which taxation is imposed on foreign dividends but a credit granted for taxes paid on the profits of the dividend distributing company.[5]

In light of its ruling, the Supreme Administrative Court referred the case back to the independent fiscal senate involved in the proceedings to have them apply the credit method in accordance with its ruling. In September 2008, however, the fiscal senate questioned whether the ruling of the Administrative Court could be a violation of Community law and submitted a preliminary ruling request to the European Court of Justice.[6] The request contains questions addressing various situations that could be compared in order to determine whether a discrimination violating Community law follows from the ruling of the highest Austrian tax court. The main thrust of the fiscal senate's questions is whether applying the credit method for foreign dividends while applying an exemption for domestic dividends is a discriminatory measure violating Community law. The questions result from establishing different pairs of comparison: domestic versus foreign dividends; foreign dividends paid from substantial participations versus foreign dividends paid from participations that are not substantial; and foreign dividends paid from within the EU and from outside the EU.

A Violation of Community Law

In essence, the fiscal senate questions the decision of the court particularly in light of two factors. First, determining the amount of taxation to be credited in Austria entails such a high administrative burden on taxpayers that crediting such taxes might not, or only with tremendous hardship, be possible. Second, it was not the intent of the Austrian legislature to have the credit method apply in situations that do not constitute an abuse.

By way of submitting a preliminary ruling request to the ECJ regarding a ruling of the Austrian Supreme Administrative Court, the independent fiscal senate took the position that such a ruling is a violation of Community law. From the perspective of the Austrian Constitution, it could be doubted whether this path is open to a lower court. Conceptually, the path is closed; lower courts are bound by the rulings of higher courts if the case was referred back to the lower court. Community law, however, opens the path, since it is not the lower court itself that decides whether the higher court complied with the law, but the ECJ.

Credit Method Equal to Exemption Method

Regarding the first main point raised by the fiscal senate, the ECJ has held that the credit method and the exemption method are generally equal for purposes of avoiding double taxation.[7] In the respective case, *Test Claimants in the FII Group Litigation*, the obstacles to determine the taxes paid by the dividend-paying company were, however, much lower than in the Austrian case in question since the shareholders held a majority participation.[8] Due to the proportionality test, the credit method should not be considered equal, since according to this test a justified restriction must not go further than required to achieve its legitimate goal.[9] Because of the administrative burden to determine the credit amount, the measure leads to a restriction that is not justified; the taxpayer will not (or only with extraordinary effort) receive the credit, which is why the legitimate goal is missed.

Moreover, in the *Test Claimants in the FII Group Litigation* ruling, the ECJ explicitly stated that only if the taxation in the source state is not higher than the taxation in the resident state can the credit method be considered equal to the exemption method.[10] The Austrian Supreme Administrative Court did not make a distinction depending on the amount of tax paid in the state from which the dividend is paid.

While the credit method and the exemption method might be considered equal from a bird's-eye view, it is not equal if, due to the underlying facts, the proportionality test is not met and if explicit case law of the ECJ stipulates that the equality depends on the foreign tax rate.

Determining Equality of Methods

The other point brought up by the fiscal senate is that the intent of the Austrian legislature was to generally implement the exemption method for dividends received by a corporation from domestic corporations as well as from foreign corporations if a 10 percent or more participation is held; the credit method was only to be used for abusive situations.[11] If the 10 percent threshold violates Community law, as was concluded

[4]For a critique on this legislative initiative, see Massoner and Stürzlinger, *Steuer und Wirtschaft International* 2008, p. 400 at 403; Wimpissinger, *supra* note 1, at 1040.

[5]*Supra* note 3.

[6]Independent Fiscal Senate (RV/0611-L/05), Sept. 29, 2008.

[7]Prechtl, *Steuer und Wirtschaft International* 2008, p. 497, at 499, referring to *Test Claimants in the FII Group Litigation* (C-446/04), Dec. 12, 2006, paras. 48 et seq.

[8]*Id.*

[9]Prechtl, *supra* note 7, at 499.

[10]*Test Claimants*, *supra* note 7, at paras. 49-57 and 60.

[11]Independent Fiscal Senate (RV/0611-L/05), Sept. 29, 2008, III.A.3, *referring to* Massoner and Stürzlinger, *supra* note 4, at 405.

by the fiscal senate and the Austrian Supreme Administrative Court, the intent of the legislature is no basis for implementing the credit method for less than 10 percent participations.[12]

The intent of the legislature is of particular importance, since the Austrian Supreme Administrative Court did not only repeal the restrictive measure but also read a new provision into the law implicitly justifying such an act of legislation by stating that the smallest change of domestic law necessary should follow from a violation of Community law. If such minimal change, however, is only oriented on preserving tax revenue and contravenes the concept of domestic law, it is highly questionable.

Discrimination From Different Perspectives

In the context of posing its questions in the preliminary ruling request, the fiscal senate establishes a couple of comparison pairs: domestic dividends versus foreign dividends; foreign dividends paid regarding a 10 percent[13] and more participation versus foreign dividends paid regarding less than 10 percent participation; and foreign dividends paid regarding less than 10 percent participations versus domestic dividends.

Shedding light on the discriminatory treatment from various perspectives provides the ECJ with yet another possibility to state whether only the comparison of a cross-border situation with a purely domestic one may lead to a violation of Community law or whether a comparison of cross-border situations could have such implications. In the *Cadbury Schweppes* ruling, the ECJ already indicated that discrimination between various cross-border situations might violate Community law, after such rationale was rejected if the discrimination was caused by income tax treaties, as was the case in the *D* ruling.[14]

Another point to be addressed by the ECJ is whether in the context of dividends received from outside the European Union a restriction can go further than the restriction for dividends received from within the EU, as was suggested by the Austrian Supreme Administrative Court based on ECJ case law.[15]

Conclusion

Based on the acte claire rule, the Austrian Supreme Administrative Court did not ask the ECJ for a preliminary ruling in the case at stake, taking the position that ECJ case law already addressed the Community law issues in question conclusively, leaving no reasonable doubts as to how to decide the relevant case.[16] The doubts of the independent fiscal senate regarding the conformity with Community law shows that the issues in dispute are far from conclusively ruled on a European level.

The interesting feature of the ECJ's decision will be how the Court tests a violation of Community law caused by a ruling of a domestic court and what the consequence will be. Generally, an ECJ ruling sets aside any national law, administrative practice, or court ruling that violates Community law. Since the fiscal senate only addresses issues resulting from the ruling of the Austrian Supreme Administrative Court, the ECJ must render a decision on the question of whether the credit method is in line with the free movement of capital. If it is not, as expected, the ruling of the Austrian Supreme Administrative Court would no longer be applicable. If the credit method is not in line with Community law, the law as it stood before the Administrative Court's decision is also a violation of Community law and, therefore, will be set aside, too. If so, the fiscal senate's original holding is confirmed and by jumping further, like a queen on a chessboard, the lower court would have trumped the higher one. ◆

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[12] *Id.*; *see also* Wimpissinger, *supra* note 1.

[13] Ten percent or 25 percent is mentioned in the independent fiscal senate's request, since in former times the 25 percent threshold applied.

[14] *Cadbury Schweppes* (C-196/04), Sept. 12, 2006, paras. 44-47; *D* (C-376/03), July 5, 2005, paras. 49-63.

[15] Austrian Supreme Administrative Court (2008/15/0064), Apr. 17, 2008, *referring to Skatteverket* (C-101/05), Dec. 18, 2007, paras. 60 et seq.

[16] *CILFIT* (283/81), Oct. 6, 1982.