REPORT FOR THE HEARING
in Case E-1/04

REQUEST to the Court under Article 34 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice by Frostating lagmannsrett (Frostating Court of Appeal), Norway, in a case pending before it between

Fokus Bank ASA

and

The Norwegian State, represented by Skattedirektoratet (the Directorate of Taxes)

concerning free movement of capital within the EEA.

I. Introduction

1. By a reference dated 23 April 2004, registered at the Court on 27 April 2004, Frostating lagmannsrett made a request for an Advisory Opinion in a case pending before it between Fokus Bank ASA (hereinafter the "Appellant") and the Norwegian State, represented by the Directorate of Taxes (hereinafter the "Respondent").

II. Facts and procedure

2. The case concerns the tax assessment of dividend payments for shares which have been the object of transactions between holders of shares in the Appellant, a bank headquartered in Trondheim, Norway, and Norwegian companies. In the tax assessment years 1997 and 1998, the Appellant distributed dividends. Immediately before the decision to pay out dividends was taken, Morgan Stanley GmbH & Co. KG, a company resident in Germany, and Lehman Brothers International, a company resident in the United Kingdom, had sold its shares to AS Toluma and Leif Hoegh & Co., two companies resident in Norway.

Morgan Stanley and Lehman Brothers had options to buy the shares sold, and these options were exercised shortly after the dividend payments had been completed. It has not been argued that the Appellant had any knowledge of the option agreements. The motivation behind these transactions was apparently that foreign shareholders are required to pay withholding tax to the Norwegian State on dividends distributed by Norwegian companies, whereas shareholders who are resident in Norway avail themselves of the imputation tax credit method and have no corresponding tax burden.

3. In accordance with normal practice, the Appellant withheld withholding tax before the company paid dividends to shareholders who, according to the register of Verdipapirsentralen ("VPS"; the Central Securities Depository), were resident outside Norway. Where the VPS register showed that the shareholders were resident in Norway, the company did not withhold any tax.

4. In 1998, the Directorate of Taxes conducted an audit with a view to identifying foreign shareholders who have attempted to avoid withholding tax on dividends. On the basis of the audit report, Trondheim ligningskontor (the Trondheim Tax Assessment Office) in 1999 notified the Appellant of a possible revision of the tax assessment. However, the tax authorities did not notify the companies resident in the United Kingdom and in Germany. Nor were those companies given any other rights as parties to the administrative proceedings.

5. In a final decision on 27 November 2001, Trondheim overligningsnemnd (the Trondheim Tax Assessment Appeals Board) found that, for tax purposes, the foreign shareholders had, at the time of distribution of the dividends, to be regarded as the owners of the shares in the Appellant. However, it was again only the Appellant that was notified and granted procedural rights as a party to the administrative proceedings. The tax decision expressly omitted to decide on the tax obligations of the Appellant and, due to a lack of jurisdiction, did not extend to the question of possible liability for withholding tax of the Appellant as distributing company.

6. The latter question was answered on 15 January 2003 by Trondheim kemnerkontor (the Trondheim Tax Collection Office), which held that the Appellant was liable for the tax obligations resulting from the reclassification of ownership.

7. The Appellant brought an action before Trondheim tingrett (the Trondheim District Court) against the Norwegian State claiming that it was not liable for assessed withholding tax even in cases where tax is assessed beyond the information contained in the VPS register at the time of distribution of dividends. On 18 June 2003, Trondheim tingrett rendered judgment dismissing the claims. The Appellant appealed against the judgment to Frostating lagmannsrett. Before that Court, questions as to the compatibility of the Norwegian imputation system, and of the procedural rules, with the EEA Agreement, were raised.

III. Questions

8. The following questions were referred to the EFTA Court:

(1) Is it consistent with Article 40 of the EEA Agreement that imputation tax credit for withholding tax is not granted to taxpayers resident in other Member States?

(a) Is it of legal significance whether the taxpayer is resident in a Member State which, in a tax agreement with Norway, has undertaken to grant credit for withholding tax?

(b) Is it of legal significance whether the taxpayer in the specific case actually is granted, or will be granted, credit for the withholding tax?

(2) Is it consistent with the EEA Agreement that a Member State deals solely with the distributing company when assessing and reassessing dividend tax (withholding tax) in those cases where the assessment decision for the foreign taxpayers is based on the assumption that the owner for tax purposes is someone other than the person who (1) is the owner under private law; (2) is registered in the VPS register as owner; and (3) is stated as owner in relation to the tax authorities, without either the owner for tax purposes or the VPS-registered owner under private law having been made aware of the reclassification?

IV. Legal background

Taxation of dividends and the imputation system under Norwegian law

9. In the relevant period from 1997 to 1998, taxation of dividends was governed by Chapter 3 of the Corporate Tax Act *(selskapsskatteloven)* of 20 July 1991 No 65.[1] Pursuant to Section 3-2 of the Corporate Tax Act, dividends received by shareholders resident in Norway from a company resident in Norway are taxable as general income.[2] Furthermore, the company's profit is taxed in full, without any credit for dividends set aside or paid out.

10. The imputation system as set up by the Norwegian tax rules is meant to avoid economic double taxation, so that income is not first taxed on the company's hand, and then taxed as dividend income on the shareholder's hand. It entails that the amount paid out as dividend to shareholders resident in Norway will be subject to taxation solely on the company's hand, as general income at a

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1 The rules have been transferred without amendment to Chapter 10 of the Tax Act (*skatteloven)* of 26 March 1999 No 14.

2 Section 3-2, sub-section 1 of the Corporate Tax Act.

rate of 28 per cent, whereas the shareholder may, subject to certain conditions, be granted a credit. This imputation tax credit will correspond to the amount of the tax paid by the company on the dividends that have been paid out.[3]

11. Imputation tax credit is granted to taxpayers with general tax liability to Norway, provided that the dividends are lawfully distributed from the company.[4] A taxpayer has general tax liability to Norway if the taxpayer in question is "resident within the Kingdom" (natural persons) or "domiciled in the Kingdom" (legal persons).[5] The practical result of the imputation system is that dividends are tax-free on the shareholder's hand as long as the taxpayer is resident or domiciled in Norway.

12. As regards dividends paid out from Norwegian companies to shareholders resident abroad, tax is due to the State at a rate determined by Parliament in its annual tax resolution.[6] The tax rate on dividends received by shareholders resident abroad is 25 per cent under domestic Norwegian law, but will often be reduced as a result of bilateral double tax agreements. In the case at hand the tax rate is 15 per cent. Imputation tax credit is not granted to taxpayers resident abroad.

Norway's double taxation agreements with Germany and the United Kingdom

13. Pursuant to Article 10 of the applicable double taxation agreements with Germany and the United Kingdom, respectively, both the home state and the source state are entitled to impose tax when dividends are distributed from a company resident in one state (source state) to a shareholder resident in another state (home state). According to the tax agreement, the right of taxation of the source state is limited to 15 per cent of the dividends. How the foreign taxpayers are taxed in their home countries was not established.

14. In order to avoid juridical double taxation of dividends—i.e. taxation of the same income both in the home state and in the source state—the tax agreements provide that the home state shall grant credit for tax paid at source, in accordance with Articles 23 (Germany) and 27 (United Kingdom), providing that the shareholder in Germany/the United Kingdom is entitled to credit in the amount of assessed tax corresponding to the tax on dividends imposed in Norway. Furthermore, Article 10(4) of the tax agreement with the United Kingdom contains a provision according to which Norwegian shareholders shall be entitled to the same imputation tax credit as taxpayers resident in the United Kingdom. There is, however, no corresponding rule entitling taxpayers resident

3 The imputation tax credit is defined as follows: "*Imputation tax credit means the dividend received multiplied by the shareholder's tax rate for general income.*", Section 3-3 of the Corporate Tax Act.

4 Section 3-4 of the Corporate Tax Act.

5 Section 15(a) and (b) of the Tax Act of 18 August 1911 No 8.

6 Section 3-5 of the Corporate Tax Act.

in the United Kingdom to the same imputation tax credit as taxpayers resident in Norway. Nor does the German tax agreement contain any such provision. The parties disagree about the prospects of the taxpayers in the case at hand being granted a credit in their home states.

Procedural rules

15. Norwegian shareholders are entitled to a range of procedural rights in connection with tax assessment decisions and reassessments.[7] Taxpayers shall be notified in the event of reassessment proceedings, and shall be given a reasonable time limit within which to submit comments. They are also entitled to access to the file. Reassessment decisions must state the reasons in writing, and the decision must be sent to the taxpayers together with information on the taxpayers' right of appeal.

16. In relation to dividend tax for foreign shareholders, the Corporate Tax Act provides for a tax calculation to be undertaken collectively for the foreign shareholders by the company.[8] Pursuant to the same provision, the distributing company is liable for the tax due from those shareholders. The company is responsible for withholding tax at the time of distribution of the dividend.[9]

17. It is the distributing company that receives notification of any changes in the withholding tax paid. In this connection, the company is granted rights as a party to the administrative proceedings, including a right of appeal. However, the right of the distributing company to submit objections in the assessment procedure does not extend to questions concerning the company's own payment liability. Any such objections must be decided in a subsequent decision by the Tax Collector. Consequently, only objections on behalf of the foreign shareholders may be raised by a distributing company in the course of the assessment procedure.

18. The foreign taxpayers do not receive notification of the assessment, nor are they granted other rights as a party to the administrative proceedings. If a foreign taxpayer wishes to appeal against the assessment or reassessment, the taxpayer is required to ask the distributing company to raise the issue on the taxpayer's behalf. Previously, the foreign shareholders had a statutory right to ask for a separate assessment. However, this right was repealed in 1984.

19. The company has rights of recourse and set-off in relation to the foreign taxpayers. Formerly, the rights of recourse and set-off were statutory. Upon an amendment of the relevant Act in 1983, the foreign shareholders became subject to advance payment of tax, and the distributing company was required by law to withhold this deduction. In this connection, the rules governing the company's

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7 Chapters 3 and 9 of the Tax Assessment Act (*ligningsloven*) of 13 June 1980 No 24.

8 Section 3-5 of the Corporate Tax Act.

9 Sections 5a and 49(1-2) of the Tax Payment Act (*skattebetalingsloven*) of 21 November 1952.

legal position were transferred to the Tax Payment Act. The right of recourse is not set out in the Tax Payment Act, but follows from general legal principles.

EEA law

20. Article 4 of the EEA Agreement reads:

> *"Within the scope of application of this Agreement, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited."*

21. Article 40 of the EEA Agreement reads:

> *"Within the framework of the provisions of this Agreement, there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in EC Member States or EFTA States and no discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested. Annex XII contains the provisions necessary to implement this Article."*

22. Article 1 of Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty[10] (hereinafter "Directive 88/361") reads:

> *"1. Without prejudice to the following provisions, Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States. To facilitate application of this Directive, capital movements shall be classified in accordance with the Nomenclature in Annex I.*
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> *2. Transfers in respect of capital movements shall be made on the same exchange rate conditions as those governing payments relating to current transactions."*

23. Article 4 of Directive 88/361 reads:

> *"This Directive shall be without prejudice to the right of Member States to take all requisite measures to prevent infringements of their laws and regulations, inter alia in the field of taxation and prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information.*
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> *Application of those measures and procedures may not have the effect of impeding capital movements carried out in accordance with Community law."*

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10 OJ L 178, 8.7.1988, p. 5; referred to in Point 1 of Annex XII to the EEA Agreement.

V. Written Observations

24. Pursuant to Article 20 of the Statute of the EFTA Court and Article 97 of the Rules of Procedure, written observations have been received from:

- the Appellant, represented by Bettina Banoun, Advocate, Bugge, Arentz-Hansen & Rasmussen, Oslo;

- the Respondent, represented by Thomas Nordby, Advocate, Office of the Attorney General (Civil Affairs), acting as Agent, and Amund Noss, Advocate, Office of the Attorney General (Civil Affairs), acting as co-agent;

- the EFTA Surveillance Authority, represented by Niels Fenger, Director, and Per Andreas Bjørgan, Senior Legal Officer, acting as Agents;

- the Commission of the European Communities, represented by Richard Lyal, Legal Adviser, and Hans Støvlbæk, Member of its Legal Service, acting as Agents;

- the United Kingdom, represented by Mark Bethell, Treasury Solicitor's Department, acting as Agent, and by Gerald Barling QC, David Ewart and Jemima Stratford, Barristers.

The Appellant

25. The Appellant submits that even if direct taxation falls within the competence of the Member States, it must be exercised in accordance with EEA law.[11] Cross-border dividends are covered by the rules on free movement of capitals and Directive 88/361.[12] Moreover, Article 40 EEA and the corresponding EC rules are to be interpreted identically.[13] The Appellant is of the opinion that the Norwegian imputation tax credit system entails both an unjustified restriction and discrimination and is therefore in breach of Article 40 EEA. It finds support for this view in a proposal by the Norwegian Government to amend the taxation rules in order to end discrimination against taxpayers in other EEA countries. Particular reference is made to a submission by the Ministry of Finance to the Parliament, outlining proposed legislation, and to the comments thereon by the

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11 Reference is made to case law of the Court of Justice of the European Communities and, inter alia, to the EFTA Court's judgment in Case E-6/98 *Norway* v *EFTA Surveillance Authority*, [1999] EFTA Court Report 74, at para 34.

12 Cases C-35/98 *Staatssecretaris van Financiën* v *B.G.M. Verkooijen,* [2000] ECR I-4071; C-315/02 *Anneliese Lenz* v *Finanzlandesdirektion für Tirol*, judgment of 15 July 2004, not yet reported.

13 Case C-452/01 *Margarethe Ospelt*, judgment of 23 September 2003, not yet reported, at paras 28-29.

Standing Committee on Finance, to the effect that the abolishment of the imputation tax credit rules will meet the EEA obligations.

26. As regards the existence of a restriction, the Appellant contends that the Court of Justice of the European Communities has answered the question of whether there is a conflict with the four freedoms if only domestic taxpayers are granted the right to an imputation tax credit against their taxable income in the affirmative in its *Avoir fiscal* judgment.[14] In *Verkooijen*, in *Lenz*, and in the Opinion of the Advocate General in *Manninen*, it was held that a more favourable taxation of dividends, depending on the company being domiciled in the same State as the shareholder, violates the free movement of capital, and that a more favourable taxation of domestic dividends entails a distorting effect.[15] Those cases and the case at issue have in common that a Member State attempts to reserve a tax advantage for shareholders domiciled in the same Member State as the dividend distributing company and to deny the tax advantage if the company and the shareholder are domiciled in two different States.[16] With regard to the Norwegian tax rules at issue, the Appellant argues that the difference in treatment of domestic and cross-border dividends in respect of the imputation tax credit will have a direct effect on the size of the net return obtained by the shareholders and will thereby affect share prices. As a consequence, persons/companies resident in Norway will be more inclined to invest than persons/companies resident outside Norway, with the effect that companies domiciled in Norway will have more difficulty attracting foreign investors and there will be a larger proportion of Norwegian shareholders in those companies.[17] Furthermore, the fact that the Appellant was held liable for the tax on dividend payable by foreign shareholders is considered a restriction of the right under Article 40 EEA in itself, since having non-resident shareholders will accordingly involve additional costs.

27. With regard to discrimination based on the residence of shareholders, the Appellant focuses on the question of whether the situations of resident and non-resident shareholders are comparable, or whether objective differences exist. It is concluded from *Avoir Fiscal* that when Norwegian law does not distinguish between Norwegian and foreign shareholders in respect of the liability for tax payable on dividend, then Norwegian law also may not distinguish in respect of the entitlement to a deduction of a tax credit associated with the taxable income

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14 Case C-270/83 *Commission* v *France*, [1986] ECR 273. In the view of the Appellant, this judgment applies even though it concerned discrimination of branches and the freedom of establishment. It is emphasized that the Norwegian imputation tax credit system was designed on the pattern of the French tax credit system.

15 Cases C-35/98 *Verkooijen*, cited above, at paras 62, 34-35; C-315/02 *Lenz*, cited above, at paras 20-21; C-319/02 *Manninen*, pending, Opinion of the Advocate General of 18 March 2004, not yet reported.

16 Further reference is made, inter alia, to the *Communication on dividend taxation of individuals in the Internal Market* of the Commission of the European Communities of 19 December 2003, COM(2003) 810, at point 3.3.1.

17 Reference is made to the preparatory works for rules on the imputation tax credit, at 8.7.2.3.

from dividends.[18] It is furthermore deduced from *Avoir Fiscal* and the subsequent case law that avoidance of juridical double taxation by way of tax agreements cannot provide grounds for foreign and domestic taxpayers not being in comparable situations, whereas the objective of avoiding economic double taxation of the company and the shareholder warrants that foreign shareholders are in a comparable situation as regards claims for tax credit.[19] Thus a principle is invoked by the Appellant whereby comparable situations exist if there is a connection between the liability for tax and the tax advantage. This principle is not limited to natural persons or branches, but also extends to corporate bodies as in the case at issue. Such a distinction is not made under Norwegian law with respect to the granting of an imputation tax credit. Finally, the Respondent's argument that it is the overall tax burden of a shareholder that is of relevance is rejected.[20]

28. As to possible justification of the restriction/discrimination, the Appellant contests that the promotion of Norwegian ownership and protection of the Norwegian tax base may qualify as mandatory requirements since they are to be considered of purely economic nature. Reference is made to the preparatory works for the imputation tax credit rules as well as to the judgment of the Court of Justice of the European Communities in *Verkooijen*.[21] It is also disputed that the rules at issue are making tax audits more efficient. With regard to justification by the requirement for coherence of the national tax system, as acknowledged by the Court of Justice of the European Communities in *Bachmann*,[22] the Appellant asserts that in view of the objective pursued, namely avoidance of economic double taxation, it is not logical or necessary that the rules should discriminate between domestic and foreign shareholders.[23] In this connection it is submitted that, whereas a Member State is free to choose whether it wants to have rules that entail economic double taxation, or rules that avoid economic double taxation, it is not possible for the Member State to adopt rules that afford tax advantages only to its own citizens. The argument that it is only in the home state that economic double taxation can be avoided is rejected. Unfavourable treatment for tax purposes in conflict with a fundamental freedom cannot be justified on the basis of the existence of other advantages in terms of tax.[24]

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18 Case C-270/83 *Commission* v *France*, cited above, at para 20.

19 Case C-315/02 *Lenz*, cited above, at paras 30-32. Further reference is made to Cases C-107/94 *P.H. Asscher* v *Staatssecretaris van Financiën*, [1996] ECR I-3089, at para 49; C-311/97 *Royal Bank of Scotland plc* v *Elliniko Dimosio*, ECR [1999] I-2651, at para 29 and C-330/91 *The Queen* v *Inland Revenue Commissioners, ex parte Commerzbank AG*, [1993] ECR I-4017, at paras 16-18.

20 Reference is made to Case C-234/01 *Arnoud Gerritse* v *Finanzamt Neukölln-Nord*, ECR [2003] I-5933, at para 55.

21 Case C-35/98 *Verkooijen*, cited above, at paras 47-48 and 59, respectively.

22 Case C-204/90 *Hanns-Martin Bachmann* v *Belgian State*, [1992] ECR 249.

23 Case C-315/02 *Lenz*, cited above, at paras 35-39.

24 Case C-35/98 *Verkooijen*, cited above, at para 61.

29. In assessing possible justification by the requirement for coherence of the international tax system, the Appellant submits that taxation imposed by other Member States and the content of tax agreements cannot affect the substance of the EEA rules,[25] and each Member State must ensure that the domestic rules do not violate the free movement of capital.[26] Any other view would lead to a relativization of the EEA rights depending on the substance of the domestic tax legislation and tax agreements with other Member States. It would also lead to a situation where discrimination shown by the home state could be used as justification for discrimination in the source state. A taxpayer making cross-border investments may thus be subjected to double discrimination. Moreover, the imputation tax credit rules and the tax agreements regulate different matters: whereas the former are intended to avoid economic double taxation and are not about dividing the tax base, the tax agreements are intended to avoid juridical double taxation. Accordingly, there is no provision in the tax agreements entitling taxpayers resident in the United Kingdom to the same tax credit as taxpayers resident in Norway, and the tax agreement with Germany has no provision entitling German shareholders to imputation tax credit in Norway along the same lines as Norwegian shareholders. In the opinion of the Appellant, it follows from international tax law that tax agreements, made for the purpose of avoiding juridical double taxation, may only be applied in reducing a taxpayer's liability for tax as regards domestic law. The fact that a tax agreement exists cannot be used as grounds for a widening of tax liabilities. In addition, it is noted that the provisions in the tax agreements do not regulate the position of the companies distributing the dividend so that they cannot influence the scope of the EEA rights as to their tax liability. Furthermore, foreign taxpayers have consistently been denied tax credit in Norway, independently of the substance of the tax agreements or the substance of the domestic tax rules of the home state. In addressing specifically question No 1(b), the Appellant expresses factual doubts as to whether the foreign taxpayers have been taxed for the dividend in their home states and are thus entitled to claim a credit in the state of residence. The main reason for these doubts is that foreign taxpayers have hardly been subjected to tax on dividends in their home countries, since they were not shareholders at the time of distribution of the dividend and therefore did not receive dividends.

30. As regards the second question from Frostating lagmannsrett, the Respondent's assumption that foreign taxpayers will be given access to appeal and trial if they were now to ask for it is rejected.[27] The Appellant submits that

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25 Case C-270/83 *Commission* v *France*, cited above, at paras 24 and 26.

26 In the opinion of the Appellant, this is not contradicted by the judgment of the Court of Justice of the European Communities in Case C-336/96 *Mr and Mrs Robert Gilly* v *Directeur des services fiscaux du Bas-Rhin,* [1998] ECR I-2793.

27 Particular reference is made to a release by the Directorate of Taxes, according to which the assessment procedure is to be practiced in a manner so as to prevent foreign shareholders from having direct contact with the tax assessment authorities. Further reference is made to the judgment of the Court of Justice of the European Communities in Case C-367/98 *Commission* v *Portugal*, [2002] ECR I-4731, according to which a change in practice is not sufficient compliance with the obligations under the EC Treaty.

the absence of rights for foreign shareholders in the administrative proceedings is contrary to Articles 4 and 40 of the EEA Agreement, and also to the non-codified requirements as to effective legal protection of rights. First, giving only Norwegian and not foreign shareholders rights as parties constitutes a differential treatment. It also amounts to a restriction, since the absence of rights as parties in connection with the taxation of dividend may have a deterring effect on foreign taxpayers as far as their desire to make investments in Norway is concerned. Furthermore, it is onerous for Norwegian companies distributing dividends to have to carry the burden of collecting the tax and possibly themselves defray the cost of the tax if the tax cannot be recovered. Thus, it becomes less attractive for Norwegian companies to have foreign shareholders, rather than Norwegian shareholders, which in itself is a restriction contrary to the EEA Agreement. The absence of rights in the administrative proceedings may also entail materially discriminatory tax rules in the Appellant's opinion, since it may result in incorrect assessment decisions. Second, the Appellant refers to the case law of the Court of Justice of the European Communities with regard to effective legal protection[28] and to fundamental rights in domestic administrative proceedings, namely the right to present evidence,[29] the right to access information in order to have the possibility of knowing the scope of EEA rights,[30] and the right of defence.

31. With regard to the Respondent's suggestions as to possible justification, the Appellant submits that purely administrative inconvenience does not qualify for justification.[31] Alternatively, the principle of proportionality must under all circumstances warrant that mandatory requirements cannot be relied upon in those instances where the tax assessment is based on reclassification of the facts and new legal backgrounds. Furthermore, the Appellant contests the Respondent's allegation that only the distributing company may be deemed to be the party that is in reality affected by the assessment. Conversely, the Appellant maintains that in reality the foreign taxpayers are assessed for tax and will have to pay the tax on dividend due to the company's right of recourse. That the distributing company may be jointly liable under Norwegian law for the tax falling on the foreign shareholders is to facilitate the collection of tax claims from the foreign shareholders and does not make the breaches of the Agreement lawful.

32. The Appellant suggests answering the first question as follows:

> *"Article 40 EEA precludes legislation in a Member State, where imputation tax credit is granted against tax on dividend to taxpayers*

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28 Case C-222/86 *Unectef* v *Georges Heylens et al.*, [1987] ECR 4097, at para 14.

29 Case C-254/97 *Société Baxter et al.* v *Premier Ministre et al.*, [1999] ECR I-4809, at para 19.

30 Case C-483/99 *Commission* v *France*, [2002] ECR I-4781, at para 50.

31 Cases C-315/02 *Lenz*, cited above, at para 48; C-334/02 *Commission* v *France*, judgment of 4 March 2004, not yet reported, at para 29.

resident/domiciled in the Member State concerned (Norway), without imputation tax credit being granted simultaneously against tax on dividend to taxpayers resident in other Member States.

Article 40 EEA precludes legislation in a Member State (Norway), where companies having foreign shareholders expose themselves to additional costs compared with the situation if the company had only Norwegian shareholders.

(a) It is of no legal significance to the application of Article 40 EEA whether the taxpayer is resident in a Member State, which has under a tax agreement with the source state (Norway) undertaken to grant tax credit for withholding tax.

(b) It is of no legal significance to the application of Article 40 EEA whether the taxpayer in the specific case is actually being granted or will be granted tax credit for the withholding tax in the state of residence.

Should the Court come to the conclusion that the tax agreements may affect the substance of the EEA rules, the Appellant suggests answering questions No 1(a) and (b) in the alternative:

It is of legal significance to the application of Article 40 EEA whether the taxpayer is resident/domiciled in a Member State, which has under a tax agreement with the source state (Norway) undertaken to grant tax credit for withholding tax, provided that the taxpayer in the specific case is actually being granted or will be granted tax credit for the withholding tax. Should it turn out that the taxpayer will in fact not be granted tax credit, then the source state (Norway) will have to grant imputation tax credit and repay any tax on dividend already paid in.

33. The Appellant suggests answering the second question as follows:

Article 40 EEA, Article 4 EEA and non-codified principles of Community law preclude taxpayers resident in other Member States being denied rights as parties in connection with the taxation of dividend while taxpayers resident/domiciled in the Member State concerned are given full rights as parties.

Should the Court come to the conclusion that EEA law does not preclude foreign taxpayers being denied rights as parties in connection with the taxation of dividend, the Appellant suggests answering the second question in the alternative:

Article 40 EEA, Article 4 EEA and non-codified principles of Community law preclude taxpayers resident/domiciled in other Member States being taxed without having been made aware of the instigation of tax assessment proceedings, so that the foreign taxpayers have been deprived of the

possibility of contradiction, appeal and trial by a court of law. In this context it constitutes a breach of the EEA rights when an assessment decision is based on the fact that a foreign taxpayer is liable for payment of tax on dividend to a Member State without being entitled to tax credit despite the fact that it is a domestic taxpayer who (1) is the owner under private law, (2) is registered in the VPS-register as owner, and (3) is stated as being the owner as regards the tax assessment authorities, and the foreign taxpayer has not been made aware of the assessment decision which reclassifies the ownership in the shares for tax purposes."

The Respondent

34. As regards the first question, the Respondent contends at the outset that the apportionment of the tax base falls within the sovereignty of the Member States[32] and stresses the differences between the EEA Agreement and the European Union, where harmonization of direct tax legislation partly exists.[33] In the areas of direct tax not covered by common legislation the Court of Justice of the European Communities has not been fully able to establish a systematic and overall picture of the requirements EC law imposes on the national systems. When it comes to international tax policy, arrangements such as channelling to the source state the right to tax on dividends paid out of profits generated there fall outside the material scope of the EEA Agreement. This is deduced from the judgment of the Court of Justice of the European Communities in *Gilly.*[34] Furthermore, the Respondent distinguishes the case at hand from the judgment of the Court of Justice of the European Communities in *Verkooijen*[35] and the Advocate General's Opinion in *Manninen*,[36] which concern dividends paid by a foreign company to a domestic shareholder.

35. In the alternative, the Respondent asserts that there is no objectively comparable situation[37] between Norwegian taxpayers and German and British taxpayers, respectively. Consequently, the different treatment resulting from the unilateral granting of imputation tax credit does not amount to discrimination within the meaning of Article 40 EEA. This conclusion is supported by the judgment of the Court of Justice of the European Communities in *Gerritse*.[38] Accordingly, the objective difference between the situations of Norwegian and foreign shareholders is that the Norwegian shareholder has general tax liability

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32 Reference is made to Case E-1/01 *Hörður Einarsson* v *Iceland*, EFTA Court Report [2002] 1, at para 17.

33 In this connection, the Respondent refers to the Parent-Subsidiary Directive 90/435/EEC and the Merger Directive 90/434/EEC, which have not been made part of EEA law.

34 Case C-336/96 *Gilly,* cited above, at para 30.

35 Case C-35/98 *Verkooijen,* cited above.

36 Case C-319/02 *Manninen*, cited above.

37 As regards this criterion, reference is made to Case C-315/02 *Lenz*, cited above, at para 27.

38 Case C-234/01 *Gerritse*, cited above, at para 44.

whereas the foreign shareholder, unless in possession of a branch or domicile in Norway, has only limited tax liability in Norway, namely for withholding tax. This is, in the view of the Respondent, not contradicted by the findings in the judgment of the Court of Justice of the European Communities in *Royal Bank of Scotland*[39] and other cases involving corporate taxation and limited tax liability, where permanent establishments of foreign companies have been discriminated against in relation to local companies. Foreign companies with a permanent establishment have, however, general tax liability and are entitled to imputation tax credit. As far as the unprecedented comparison between companies established in different Member States in relation to the withholding tax is concerned, a comparison must, according to the Respondent, be made of the total tax burden on the dividends, because the credit method in the taxpayer's home state is applied in order to avoid double taxation. Thus, instead of comparing the foreign shareholder with the Norwegian shareholder in Norway, the correct approach would be to compare the foreign shareholder's situation in Germany and the United Kingdom, respectively, with the Norwegian shareholder's situation in Norway.

36. Alternatively, the Respondent maintains that there exists no breach of Article 40 EEA on the basis of two criteria established by the Commission of the European Communities in its recent Communication.[40] It is essentially argued that there is no causal link between the Norwegian tax burden (i.e. the withholding tax) and the investment choice made by the taxpayer. The withholding tax does not prevent a German or British shareholder from investing in Norwegian companies since the relevant tax agreements with Germany, the United Kingdom, and other EEA States are based on the credit method for the avoidance of double taxation. The credit method implies that taxpayers may deduct the withholding tax that has been paid to the Norwegian State from their income tax in the home state. Since the tax burden remains constant as a result of the tax agreement, the choice made by the taxpayers is not adversely affected. The Respondent finds support in an *e contrario* argument from the judgment of the Court of Justice of the European Communities in *Lenz*.[41] As to the question of why foreign taxpayers should enter into the kind of arrangements with Norwegian shareholders as described above if the withholding tax does not constitute any burden on them, the Respondent assumes that the fiscal situation in the home state may suggest that it could be advantageous for the taxpayer to engage in parking arrangements and thereby forgo credit deductions for withholding tax imposed in Norway, by seeking to shield the entire dividend from taxation in the home state. It is stressed, however, that the taxpayer's subjective motivation is of no significance in the evaluation conducted by Norwegian tax authorities. Finally, the Respondent considers crucial that avoiding double taxation in any case is a challenge for the home state, not the

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39 Case C-311/97 *Royal Bank of Scotland*, cited above, at para 29.

40 *Communication on dividend taxation of individuals in the Internal Market*, cited above.

41 Case C-315/02 *Lenz*, cited above, at para 38.

state of source.[42] Consequently, the differences between Norwegian and foreign shareholders are due to the absence of rules granting relief for economic double taxation with regard to dividends from Norway in the shareholder's home state.

37. As to justification of a possible infringement of Article 40 EEA, the Respondent suggests that the Court acknowledges the need to maintain the coherence of the international tax system as a mandatory requirement. This is distinguished from a justification based on domestic fiscal coherence and has not yet been assessed by the Court or the Court of Justice of the European Communities.[43] This interest—which has not as an objective the securing of tax revenue, *i.e.* it is no interest of an economic nature—is pursued in a necessary, suitable, and proportional way by means of apportionment of the tax base among Member States through tax agreements, based on the OECD Model Tax Convention. The guiding principle in international tax law is that the avoidance of double taxation is a matter for the home state of each taxpayer, because only that state has a full overview of the income and capital of the person in question. There is no basis for asserting the existence of a general principle of EEA law, according to which income should be taxed only once. For this reason, the Respondent claims that there is broad acceptance for the use of withholding tax. Should the Court ban withholding tax, i.e. reach the conclusion that imputation tax credit should be granted in Norway, this would in reality entail the transfer of the right of taxation from the source state to the home state and thereby would run contrary to the coherence of the international tax system. At issue in the present case is coherence between the withholding tax in Norway and the credit given in the home state involving the same tax and the same taxpayer. Thus, a direct link exists, in the case of one and the same taxpayer, between the withholding tax in Norway and the offsetting of that tax through credit given in the home state, both of which related to the same tax.

38. The second question is, in the opinion of the Respondent, of minor EEA relevance. The procedural matter raised in this question is to be dealt with by the national court based on national rules. EEA law cannot be held to implement procedural requirements that are not already a part of national law. Moreover, the Respondent assumes that there cannot be a breach of EEA procedural requirements provided it is consistent with Article 40 EEA that imputation tax credit for withholding tax is not granted to taxpayers resident in other Member States. In such a case, it must be clear that the possible lack of procedural rights has had no impact on the tax authorities' assessment. On the other hand, should there be an infringement of Article 40 EEA, this does not automatically imply that procedural requirements in the EEA Agreement have been violated.

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42 The Respondent refers in this regard to the Advocate General's Opinion in Case C-319/02 *Manninen*, cited above, at para 68.

43 Reference, however, is made to Case C-436/00 *X and Y* v *Riksskatteverket*, [2002] ECR I-10829, at para 53.

39. As to the compatibility of the Norwegian procedural system with the EEA Agreement, the Respondent concedes that the foreign taxpayers were not granted rights as parties to the administrative proceedings. In fact, it has never occurred that foreign taxpayers have filed complaints or proceedings in order to challenge tax reclassifications. It is, however, not excluded from possibility but even likely in the Respondent's view that if they did, they would be accepted and dealt with by the tax authorities.[44] Moreover, the Respondent contends that it is not the foreign shareholder who is adversely affected, but the distributing company that is liable for payment of the tax assessed on the former. It must be for the company to approach the shareholders or their brokers, with a view to possibly obtaining information that may modify the reassessment. It is furthermore normally unnecessary to notify the foreign shareholder since the information required for the assessment of withholding tax can efficiently be acquired from the distributing company, from the VPS register, and through tax audits. As the substantive question of compatibility with Article 40 EEA is an abstract legal one, it is considered unlikely that additional information from the foreign taxpayers could have altered the Norwegian tax authorities' decision in the case at issue. Consequently, the lack of contact with the foreign shareholders cannot have influenced the assessment decision. Finally, the Respondent concludes from a comparative survey of selected legal orders that other EEA Member States use virtually the same procedure as Norway.

40. The Respondent suggests answering the questions as follows:

> *"(1) It is consistent with Article 40 EEA that imputation tax credit for withholding tax is not granted to taxpayers resident in other EEA Member States when the taxpayer is resident in a EEA Member State which, in a tax agreement with Norway, has undertaken to grant credit for withholding tax.*
>
> *(2) It is of no legal significance for Norway, i.e. the state of source, whether the taxpayer in the specific case actually is granted, or will be granted, credit for the withholding tax in his home state.*
>
> *(3) It is consistent with the EEA Agreement that a member state deals solely with the distributing company when assessing and reassessing dividend tax (withholding tax) in those cases where the assessment decision for the foreign taxpayers is based on the assumption that the owner for tax purposes is someone other than the person who (1) is the owner under private law; (2) is registered in the VPS register as owner; and (3) is stated as owner in relation to the tax authorities, without either the owner for tax purposes or the VPS-registered owner under private law having been made aware of the reclassification."*

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44 The Respondent bases this assumption on the wording of Section 48(5) of the Tax Payment Act and Sections 3-7(1), 9-2(5) of the Tax Assessment Act.

The EFTA Surveillance Authority

41. With regard to the first question, the Respondent's assertion that the apportionment of tax bases falls outside the material scope of the EEA Agreement is rejected. In the view of the EFTA Surveillance Authority, the difference in treatment does not follow from the allocation of tax powers in double taxation agreements. As a point of departure, it is deduced from the judgment of the Court of Justice of the European Communities in *Gilly*[45] that EEA law does not prevent EEA States from laying down in double taxation agreements nationality or residence as the connecting factor for the taxation of income that otherwise would be subject to taxation in two or more States. However, unlike in *Gilly*, the tax agreements in the case at issue do not have as an object preventing the same income from being double taxed. Conversely, the agreements presuppose that a company's profit distributed to a non-resident shareholder may be subject to taxation in both States. The tax agreements do not entail any reduction of double taxation since the companies' profits are subject to regular company tax in Norway and are then again fully taxed in Germany and the United Kingdom as dividends. The only element in the agreements concerning allocation of taxation power relates to the partial allocation back to Norway of Germany's and the United Kingdom's competence to tax the dividends. By making the dividends to non-residents subject to partial economic taxation in Norway, juridical double taxation is reduced in the other States. Thereby, the agreements do not reduce the overall tax burden following from two States fully exercising their taxation powers. Furthermore, it is the tax advantage for resident shareholders laid down in national tax law, and not the connecting factor for allocation of tax power, as in *Gilly,* that leads to the difference in treatment. The tax agreements do not impose an obligation on Norway not to tax resident shareholders in Norway, and nothing prevents Norway from granting to non-resident taxpayers the same advantage granted to resident taxpayers, since the tax agreements provide a right, not an obligation, to apply withholding tax.

42. Furthermore, the rejection of the Respondent's argument is in the view of the EFTA Surveillance Authority supported in a more general way by the allegation that only because a double taxation agreement is involved, an EEA State is not released from its obligation to exercise its fiscal power in compliance with EEA law. In this respect a distinction is drawn between the allocation of tax powers and the exercise of fiscal power. By reference to the Court's case law, the EFTA Surveillance Authority states that the EEA States must exercise their taxation power consistently with EEA law.[46] Moreover, the fundamental freedoms in the EEA Agreement are unconditional in the sense that the EEA States cannot make respect for them subject to the contents of an agreement con-

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45 Case C-336/96 *Gilly,* cited above, at para 30.

46 Case E-1/03 *EFTA Surveillance Authority* v *Iceland,* [2003] EFTA Court Report 145, at para 26.

cluded with another State.[47] It would render the provision in Article 40 EEA unduly ineffective if EEA States could justify discriminatory provisions in national law with an argument that such discrimination occurs within a field regulated by a double taxation agreement. This is even more true with regard to a taxation agreement that actually is neutral in relation to a potentially discriminatory provision in national law.

43. The question of whether the situations of resident and non-resident shareholders are comparable is answered in the affirmative by the EFTA Surveillance Authority. It submits that an EEA State cannot differentiate merely on the basis of residence and non-residence if objective differences do not exist.[48] The EFTA Surveillance Authority concludes from the judgments of the Court of Justice of the European Communities in *Royal Bank of Scotland*[49] and in *Compagnie de Saint-Gobain*[50] that the fact that a shareholder is a taxpayer in two different tax jurisdictions does not put the shareholder in a situation incomparable to that of a taxpayer subject to tax from only one source. The EFTA Surveillance Authority does not accept a distinction from *Royal Bank of Scotland* since the scope of a permanent establishment's limited tax liability cannot constitute a distinguishing factor as to other taxpayers that also have limited tax liability. Furthermore, a permanent establishment does not necessarily have income from more sources than a non-resident shareholder. The tax measure at issue concerns only the tax treatment of income from that single source, which is the dividend distributed by a Norwegian company. Finally, the imputation tax credit is granted solely to avoid economic double taxation of the Norwegian company's profit and is not in any way linked to, or considered in connection with, resident taxpayers' general tax liability on worldwide income, neither to their personal ability to pay tax, nor to their personal and family circumstances or to the progressiveness of the national tax system. The reason for not expanding the tax advantage to cover non-resident shareholders is, primarily, a desire to protect the Norwegian tax base. The EFTA Surveillance Authority refers in this regard to the preparatory works. The difference in treatment is thereby, in the view of the Authority, not linked to different tax situations for residents and non-residents, but merely based on that State's considerations of a purely economic nature—a desire to increase tax revenue.

44. With regard to the existence of a restriction under Article 40 EEA, the EFTA Surveillance Authority argues that as a consequence of not being granted an imputation tax credit, the non-resident shareholder will receive a lower dividend from a Norwegian company than a resident shareholder, even if the portions of the company's profit distributed as dividends are equal for the two

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47 Cases C-270/83 *Commission* v *France,* cited above, at para 26; C-307/97 *Compagnie de Saint-Gobain*, [1999] ECR I-6161, at para 57.

48 Reference is made to Case C-234/01 *Gerritse*, cited above, at para 27.

49 Case C-311/97 *Royal Bank of Scotland*, cited above, at para 29.

50 Case C-307/97 *Compagnie de Saint-Gobain*, cited above, at paras 47-48.

shareholders. By this difference in treatment, investment in Norwegian companies is made more attractive for residents than for non-residents and may dissuade potential non-resident investors from acquiring shares in Norwegian companies. Thus, the national provisions will also make it more difficult for Norwegian companies to raise capital in other EEA States.[51] The argument raised by the Respondent, namely that the total tax burden remains constant due to the provisions in the tax agreements that permit taxpayers to deduct the tax withheld in Norway in their income tax in their home states, is rejected. In the EFTA Surveillance Authority's view, that argument is based on a misunderstanding of what the relevant basis for comparison is. In fact, where resident and non-resident taxpayers are in comparable situations, there shall be no difference in treatment in the State where the fundamental freedom of Article 40 EEA is exercised, which is not the case in Norway. Unfavourable tax treatment cannot be justified by the existence of other tax advantages that will compensate for the disadvantages of not being allowed the tax concessions in question, even supposing that such advantages exist.[52]

45. As regards possible grounds for justification, the EFTA Surveillance Authority fails to see the relevance of the arguments put forward by the Respondent. The relevant double taxation agreements neither provide for a difference in treatment nor prohibit equal treatment. In particular, the OECD Model Tax Convention does not provide that dividends shall be tax-free in the source state only for resident taxpayers. The international tax system of general tax liability combined with limited taxation at source is, therefore, not as such contrary to the EEA Agreement. Article 40 EEA, however, requires that Norway exercise its taxation power consistently with the fundamental freedoms in the EEA Agreement. Furthermore, by shifting the responsibility of avoiding double taxation to Germany and the United Kingdom, Norway itself imposes economic double taxation on the dividends distributed to non-resident shareholders. If Germany or the United Kingdom were to avoid double taxation, they would, in addition to having to restrain themselves from exercising their own legitimate taxation power, have to reimburse the shareholder the tax withheld in Norway. Finally, granting resident shareholders a tax credit in order to avoid economic double taxation when that credit is denied non-resident shareholders in order to increase tax revenue cannot be justified under Article 40 EEA. Again, reference is made to the rationale behind the Norwegian system as laid down in the preparatory works.

46. The answer to the second question should, in the EFTA Surveillance Authority's view, be in the negative. This suggestion is supported by two main arguments. First, the lack of procedural rights for non-resident shareholders

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51 In this connection, reference is made to the judgment of the Court of Justice of the European Communities in Case C-35/98 *Verkooijen,* cited above.

52 Reference is made to Cases C-35/98 *Verkooijen*, cited above, at para 61; C-307/97 *Compagnie de Saint-Gobain*, cited above, at para 53; C-270/83 *Commission* v *France*, cited above, at para 21.

violates the principle of equal treatment at procedural level as laid down in the *Schumacker* judgment of the Court of Justice of the European Communities.[53] The lack of procedural rights in proceedings concerning tax liability may dissuade potential non-resident investors from acquiring shares in Norwegian companies and amounts therefore to a restriction on capital movements within the meaning of Article 40 EEA. Non-resident shareholders are directly affected by the tax authority's decision since their tax liability is the subject of the reassessment procedure and they will have to reimburse the distributing company. Second, the EFTA Surveillance Authority bases itself on the Court's *Ásgeirsson* judgment, according to which provisions of the EEA Agreement are to be interpreted in the light of fundamental rights.[54] This includes the right of defence, particularly the right to an adversarial procedure in which the parties can make their views known effectively.[55] As the system established under Norwegian law does not secure an effective right for a taxpayer to make known the taxpayer's views, it is in violation of the defence right. With regard to the assertion that lack of procedural rights cannot influence the assessment decision since the audit conducted has exhaustively clarified the facts, the EFTA Surveillance Authority points out that the tax authorities did not consider the EEA aspects of the reassessment decision. In any case, a party's fundamental right to present its views cannot depend on whether the case is complicated or not.

47. The EFTA Surveillance Authority suggests answering the questions as follows:

> *"Article 40 EEA prohibits a difference in treatment consisting of granting a resident shareholder an imputation tax credit in tax on dividends received from a company established in Norway when that credit is not granted to non-resident shareholders in the same company.*
>
> *Article 40 EEA combined with general principles of EEA law requires equal treatment at procedural level for non-resident and resident shareholders in proceedings concerning assessment and reassessment of dividend tax and, furthermore, an effective right for a non-resident taxpayer to make known his views in such proceedings."*

The Commission of the European Communities

48. In examining the first question, the Commission starts out by submitting that Article 40 is applicable to the circumstances of the present case. Even though the tax systems of the EEA States are not, as a general rule, covered by the EEA

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53 Case C-279/93 *Finanzamt Köln-Altstadt* v *Roland Schumacker*, [1995] ECR I-225, at para 58; Case C-175/88 *Biehl* [1990] ECR I-1779.

54 Case E-2/03 *Ásgeirsson*, [2003] EFTA Court Report 185, at para 23.

55 Cases C-395/00 *Distillerie Fratelli Cipriani SpA*, judgment of 12 December 2003, not yet reported, at para 51; C-78/01 *BGL*, judgment of 23 September 2003, not yet reported.

Agreement, the States must exercise their taxation power consistently with EEA law.[56] The provisions of Article 40 EEA and Article 56 EC are identical in their substance[57] and should consequently be interpreted in the same way. Although the receipt of dividends may not itself constitute a movement of capital, it implies the previous acquisition of the underlying securities, which does constitute capital movement.[58]

49. As to the question of whether the fact that non-resident shareholders do not benefit from an imputation tax credit constitutes restriction or discrimination, the Commission assesses the nature of the imputation tax credit. In reality, it amounts to an exemption for resident shareholders. The application of a higher tax burden to non-resident shareholders constitutes an obstacle to the free movement of capital, as the less favourable treatment of cross-border investment is likely to dissuade non-residents from investing in Norwegian companies, and to constitute a barrier for Norwegian companies in raising capital from foreign sources. Furthermore, it leads to a difference in treatment compared to non-resident shareholders. Whether this difference corresponds to an objective relevant difference between the situations of residents and non-residents for the purpose of taxation of dividends[59], and whether the restriction on free movement of capital is justified, are assessed in conjunction.

50. In this regard, the Commission refers to the case law of the Court of Justice of the European Communities whereby accepting residence as the connecting factor on which international tax law typically allocates powers of taxation between States as a general rule would deprive the fundamental freedoms of all meaning.[60] Instead, the distinction between a resident and a non-resident must have significance in the system of taxation. In this respect, the Commission, in the light of the judgments of the Court of Justice of the European Communities in *Schumacker*, *Asscher*, and *Gerritse*, finds it difficult to see any useful distinction between the application of a higher rate of tax to non-residents and the taxation of non-residents when residents are not taxed at all. Nor does it see any obvious reason for the imposition of a tax on non-residents when residents are not taxed on the same type of income.

51. With regard to the argument that Article 40 EEA does not apply to the apportionment of the tax base between States pursuant to a double tax agreement, which is based on the judgment of the Court of Justice of the European Communities in *Gilly*, the Commission submits that what is at stake in the case at issue is not the apportionment of the right to tax, but the manner in which that

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56 Cases E-6/98 *Norway* v *EFTA Surveillance Authority*, cited above, at para 34; E-l/01 *Einarsson*, cited above, at para 17; E-l/03 *EFTA Surveillance Authority* v *Iceland,* cited above, at para 26.

57 Case C-452/01 *Ospelt*, cited above.

58 Reference is made to Case C-35/98 *Verkooijen*, cited above, at para 30.

59 Reference is made to Case C-311/97 *Royal Bank of Scotland*, cited above, at para 26.

60 Case 270/83 *Commission* v *France*, cited above.

right is exercised. Whereas the double tax agreements do give Norway the right to charge tax on certain income received by non-residents, it may not, under Article 40 EEA, exercise that right in a discriminatory manner.

52. As concerns the Respondent's argument that no additional tax burden is put on non-residents since they will be granted a tax credit in the home state, the Commission contends that regardless of whether credit is provided for under the applicable double tax agreements, such arrangements cannot justify a breach of an obligation under the EEA Agreement. Unfavourable tax treatment contrary to a fundamental freedom cannot be justified by the existence of other tax advantages in another Member State.[61] Moreover, the tax credit enjoyed by the Norwegian residents and the tax credit to which non-residents are entitled under the double tax agreements may not be confused. The effect of the former is that no further tax is charged in addition to the corporate tax paid by the company that distributes dividends. The latter simply has the effect that the additional tax charged in Norway must be allowed for in the calculation of any further tax payable by the foreign shareholder in the shareholder's home country. Finally, as the basic rule laid down in the Norwegian legislation does not depend on the availability of a tax advantage in another State, it cannot be justified with arguments based on the terms of a double tax agreement.

53. With respect to alleged justification on grounds of a need to maintain the coherence of the international tax system, the Commission reiterates that what is at stake is not the attribution of tax jurisdiction but the exercise of that jurisdiction. A ban on withholding tax would not amount to the transfer of taxing rights from the source state to the resident state. It would merely prevent Norway from exercising its taxing rights in a discriminatory manner. As concerns the argument that the avoidance of double taxation is a matter for the home state of each taxpayer, the Commission maintains that the application by Norway of a withholding tax makes it impossible for the home state, even if it so wished, to eliminate double taxation, short of repaying to its taxpayers the tax charged in Norway. The exercise by Norway of its rights under the double tax agreements does not avoid but instead creates double taxation, as in relation to non-residents it levies an amount of tax in addition to the corporate tax paid by the company distributing the dividends.

54. In the view of the Commission, the second question requires an answer only if the Court should answer the first question in the affirmative. The Commission observes at the outset that although procedural tax rules of an EEA State are not, as a general rule, covered by the EEA Agreement, they have to be implemented in a manner consistent with EEA law. Consequently, the mere fact that the distributing company must act as a kind of fiscal representative for the foreign shareholder is not in principle incompatible with the free movement of capital. However, the need to ensure the presence in Norway of a person or entity

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61 The Commission refers to Cases 270/83 *Commission* v *France*, cited above, at para 21; C-307/97 *Compagnie de Saint-Gobain*, cited above, at para 53, concerning Article 43 EC.

liable for the payment of tax and the fulfilment of other tax obligations does not justify a rule that makes it impossible for non-resident taxpayers to defend themselves in proceedings that directly or indirectly affect their rights by charging tax on the dividends they receive. The exclusion of any right to be heard is not justified by any overriding consideration of public interest.

55. The Commission of the European Communities suggests answering the questions as follows:

> *"(1) Article 40 EEA precludes the application of a withholding tax on dividends distributed to non-resident shareholders where the State in question does not tax dividends distributed to residents. That is true irrespective of the availability of a tax credit for non-resident shareholders under any double tax convention between that State and other States.*
>
> *(2) Article 40 EEA precludes the application of a rule under which an assessment decision for foreign taxpayers is made without either the owner for tax purposes or the VPS-registered owner under private law being made aware of the procedure leading to that decision or being entitled to participate in those proceedings."*

The United Kingdom

56. In the view of the United Kingdom, which limits itself to addressing the first question, the acquisition by non-residents of domestic securities is an operation that falls within the scope of Article 40 EEA and Directive 88/361. As Article 4 EEA applies independently only to situations in regard to which the EEA Agreement lays down no specific non-discrimination rules, the latter provision is not taken into account. As to the scope of prohibition contained in Article 40 EEA, the United Kingdom submits that Member States may apply residence as a distinguishing factor, provided that it is applied to situations that are not objectively comparable[62] or justified by overriding reasons in the general interest, in particular in relation to the coherence of the tax system.[63] These principles also apply to the interpretation of Article 40 EEA. The United Kingdom proposes that no prohibited restriction on free movement of capital exists, or any such restriction would be justified.

57. As a starting point, the United Kingdom contends that according to the case law of the Court of Justice of the European Communities the situations of resident and non-resident persons as well as companies are not comparable in relation to direct taxes so that treating both situations differently is not discriminatory. In the case at issue, the situations of resident and non-resident companies are different. Dividends received from Norwegian companies by

62 Case C-279/93 *Schumacker*, cited above.

63 Cases C-204/90 *Bachmann*, cited above; C-300/90 *Commission* v *Belgium*, [1992] ECR I-305.

resident shareholders are granted a tax credit because those dividends are taxable as general income in the hands of the recipient shareholders. Thus, economic double taxation is avoided. Dividends received by non-resident shareholders are not capable of being taxable as general income in the hands of the recipients in this way, for the recipients are not generally subject to the Norwegian tax system. Therefore, such dividends are not comparable to dividends received by resident shareholders.

58. The elimination of economic double taxation of a company and its shareholders must be dealt with by bilateral negotiations in cross-border situations.[64] The Norwegian approach entailing a difference in treatment between the situations of resident and non-resident shareholders is considered to be in line with international tax law, in particular Article 10 of the OECD Model Tax Convention and the commentary thereon. The United Kingdom finds it logical that the resident shareholder who receives a dividend from a resident company should have to look entirely to the shareholder's state of residence for alleviation of any double taxation to which it is subject, since such a shareholder can have no recourse elsewhere and only the home state has a complete overview of the shareholder's tax position.[65] The same applies to the non-resident shareholder in respect of its home state. Accordingly, Norway under the double taxation agreement alleviates economic double taxation by applying a reduced rate of withholding tax on the dividends paid to non-resident shareholders. It is left to the shareholder's home state to grant further relief as the taxation agreement in question may provide. Given that the shareholder is generally subject to the tax system in its home state rather than in Norway, it is appropriate that the former should play its part in relieving double taxation.

59. As to the principle of fiscal cohesion, the United Kingdom notes that the Court of Justice of the European Communities has sometimes appeared to adopt a restrictive approach by giving the impression that this ground of justification is available only where a direct link exists, 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, where both the advantage and the levy relate to the same tax.[66] This predominance of the criterion of the same taxpayer has, in the view of the United Kingdom, been put into perspective by the Advocate General, who in *Manninen* defined preconditions for accepting a link justifying reliance upon fiscal cohesion where a levy on one taxpayer is offset by relief for another.[67] As in the case at issue, the taxation relates to the same income, and the advantage of a tax credit does not appear to accrue to the taxpayer until the disadvantage to

64 Cases C-336/96 *Gilly,* cited above, at paras 23-24, C-385/00 *de Groot*, [2002] ECR I-11819, at paras 99-100.

65 Reference is made to Case C-385/00 *de Groot*, cited above, at para 98.

66 Case C-35/98 *Verkooijen*, cited above, at paras 57-58.

67 Opinion in Case C-319/02 *Manninen*, cited above, at paras 60-62.

the company of a full charge on its profits, without credit for dividends paid out, has been borne, these preconditions are satisfied.

60. Moreover, since the aim of the relevant Norwegian provisions is to eliminate double taxation and there is a direct correlation between the amount of tax paid by the company in respect of the dividends paid out and the tax credit granted to the recipients of a dividend, these provisions form a fully integrated system in which the same income and the same tax are dealt with in the taxation of two taxable persons. Accordingly, the distinction between resident and non-resident shareholders is required for the cohesion of the Norwegian tax system and also for the cohesion of internationally agreed principles of taxation. If Norway were required unilaterally to give a tax credit to a non-resident shareholder, the principle of fiscal cohesion, in particular, would be rendered meaningless in relation to Member States that have adopted systems of imputation or shareholder relief. If that principle were indeed to be dependent on a situation where the relevant levy and grant apply in respect of the same taxpayer and the same tax, those Member States could either (1) withdraw tax credits in respect of dividends paid to resident shareholders from resident companies or (2) accord equivalent relief to recipients of dividends regardless of their country of establishment. Economic double taxation would be the consequence of the first option, and the effect of the second option would be to end the system of apportioning tax rights through bilateral treaties. Finally, the United Kingdom points to the worldwide recognition and acceptance of imputation or shareholder relief systems as an appropriate solution to avoid double taxation of company dividends.

61. The United Kingdom suggests answering the first question as follows:

> *"It is not contrary to Article 40 EEA for the Norwegian tax authorities to grant a tax credit to taxpayers who are resident/domiciled in Norway, without granting the same tax credit to taxpayers who are resident/domiciled in other Member States."*

Carl Baudenbacher
Judge-Rapporteur