MOST –FAVOURED –NATION CLAUSE IN THE LIGHT OF EC CASE C-335/05 RIZENI LETOVEHO PROVOZU CR, S.P.V.BUNDESAMNT FUR FINANZEN

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Abstract
This article considers the institution of most-favored-nation clause in the light of EC case C-335/05 Rizeni Letoveho Provozu CR, s.p. v. Bundesamnt fur Finanzen. The case was regarded as the World Trade Organization Agreements -General Agreement on Tariffs in Services, EC law, German law and Czech Republic law. The main issue of this article is to present the relation between those regulations and legal bases for the settlement of the dispute

Key words
The World Trade Organization (WTO), Valued Added Tax (VAT) refund, General Agreement on Tariffs in Services (GATS), Thirteenth Council Directive 86/560/EEC of 17 November 1986 on the harmonisation of the law of the Member States relating to turnover taxes, the most-favoured-nation clause.

1. INTRODUCTION

One of the basic principles of the international tax law is the rule of Non-discrimination between trade partners. This rule is presented in the World Trade Organization (WTO) Agreements[1]. The principle of Non-discrimination is two fold. The first one is called national treatment which means that a WTO member country is obliged to treat other WTO members countries in the same way as they treat their own members[2].

The second one reflects the most –favoured- nation treatment. This principle is incorporated into General Agreement on Tariffs and Trade (GATT)[3], General Agreement on Tariffs in Services (GATS)[4] and Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) subject to limited exemptions, countries cannot normally discriminate between trading partners[5].

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[1] In 1994, the WTO was established as a consequence of the Urugway Round of multilateral trade negotiations. The legal basis of its functioning are based on three main agreements: General Agreement on Tariffs and Trade 1994 (GATT), GATS and the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS).

[2] This principle is also included in all three main WTO Agreements and has different meaning.

[3] The most -favourite nation clause of GATT has a much narrow scope than that of their analogous provision of GATT. G.Cappadona, National Report Italy [in:] WTO and Direct Taxation , ed. M. Lang, J. Herdin, I. Hofbauer, Eucotax Series on European Taxation, vol.10.The Netherlands**,** ISBN 3-7073-0710-7, p. 431.

[4] GATS is the multilateral agreement aiming at establishing a framework of principles and rules for trade in services.

[5] I. Amiel, S. Menuhin, National Report Israel [in:] WTO and Direct Taxation..., p. 408.

Each of the WTO Agreements has a different meaning. In this article my consideration will be restricted to the most – favoured - nation clause in the light of GATS Agreement, only[6].

2. THE MOST-FAVOURED -NATION CLAUSE

Directly speaking the most -favoured –nation clause means "favour one, favour all". A country should not discriminate between its trading partners. If a WTO member grants someone a special favour (such as lower custom duty) it should be done the same for all other WTO members. This rule is established in article II of the GATS [7] "with respect to any measure covered by this Agreement, each Member shall agree immediately and unconditionally to services and service suppliers the same as the treatment of other members and no less favourable[8] than that it accords like services and service suppliers of any other country".

The term "services" is defined in article I (3) (b) GATS which means any service in any sector except services supplied in the exercise governmental authority. The latter article I (3)(c) GATS explains that "a service supplied in the exercise of governmental authority" means any service which is supplied neither on a commercial basis, nor in competition with one or more service suppliers.

According to article II (2) a member may maintain a measure inconsistent with article II (1) provided that such a measure is listed in its most-favoured- nation clause, subject to negotiation in subsequent trade liberalization meetings. A few exemptions were made in the schedules to the Financial Services Agreement. For instance Italy stated a preferential tax treatment for financial service suppliers from former communist countries in Eastern Europe and the Soviet Union for a ten-year-period. Such a decision was made because those countries were concerned in their transition to a market economy[9].

However there are some exceptions to the most-favourable-national clause. They are contained in article XIV GATS. In fact, the whole system of implementation and negotiations of GATS commitments is based on exceptions and the limitation of market access and national treatment. Members make or maintain commitments on the basis of a schedule of concessions[10].

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[6] The most favoured nation clause and national treatment clauses of GATS have a much wider scope than related provisions of for instance GATT. G. Cappadona, National Report Italy …op.cit, p.431.

[7] There are two economic trends in the world economy. Firstly, a lot of developed countries such as for example the United States state that, measured by percentage of gross domestic product, their economies produce more services than goods. Therefore services viewed collectively have become the dominant sector of the major industrial – or rather post-industrial –economies. Secondly, countries that have lost their comparative advantage in the production of some goods now believe their advantage lies in trading certain services. A. F. Lowenfeld, International Economic law, Oxford University Press 2003, ISBN 0-19-82-5667-1 p. 111.M. M. Kałduński, Klauzula największego uprzywilejowania, Toruń 2006. ISBN 83-7285-298-7, p. 349-356.

[8] In the EC-Bananas III case a Panel was considered the meaning of the most-favoured-nation clause. It was stated that "treatment no less favourable" should be interpreted to include *de facto*, as well as *de jure* discrimination. WTO Appellate Body and Awards 1995-2005, Cambridge University Press 2006,.ISBN -13 978-0-521-86602, p. 314

[9] A. F. Lowenfeld, International Economic Law…op.cit, p. 124.

[10] V. Bobek, L.Hauptman, S.Beloglavec, National Report Slovenia [in:] WTO and Direct Taxation… op. cit, p. 620.

3. THE CASE BACKGROUND (CASE C- 335/05)

The most -favoured -nation clause was a consideration by the EC Court of Justice in case C-335/05. Judgement of the Court made on 7 th June 2007. The legal framework of this case is as follows: Rizeni Letoveho Provozu CR, sp. z o.o – plaintiff from the Czech Republic was a company which provided services to the airline security sector in the form of flying instruction. This company was located in the Czech Republic. In 2002 the Czech company during the airline instruction activities used flight simulator training which was located in Germany. The services provided were taxed according to German law. Therefore the Czech company had to pay VAT on the services provided. In 2003 the Czech company asked the German tax office (Bundesamnt fur Finanzen) for a tax refund for the one year period from January 2002 to December 2002. The Czech company was refused a tax refund by the German finance office. It was said that the non fulfilment condition of reciprocity which results from the sixth sentence of article 18(9) of the German law of 1999 on turnover tax (Umsatzsteuergesetz, then UStG) was the reason for rejection. It means that in those times the VAT paid by the German company for work carried out by the Czech company was not eligible for refund. Consequently the plaintiff appealed to the higher court, but it was also rejected. Then the Czech company in 2004 brought proceedings before the National Court (Finanzgericht Koln).

4. COURT ANALISIS AND CONCLUSION

The National Court stated that, during the reference period for the refund, the Czech Republic levied a turnover tax but did not grant German companies a refund of the input tax. It is worthy of note that, the national court had doubts whether the sixth sentence of article 18(9) of the German law is compatible with the article 2 (2) of the Thirteenth Council Directive 86/560/EEC dated 17 November 1986 on the harmonization of laws of the Member States relating to turnover taxes[11] and reflects its wording.

The National Court stated that the GATS is a type of an international agreement which establishes rights and obligations only between members. Therefore the infringement of any GATS articles should be solved according to the WTO settlement disputes procedures. But the Court stated that it does not mean that interpretation and applying secondary Community legislation should not be done in the light of GATS, even though the Community acts was adopted before becoming a WTO Member. Therefore art. 300 (7) in relation with art. 133 (3) EC[12] states that agreements such as GATS are binding on the institutions of Community and the Member States and forms an integral part of the Community legal order. Both the Czech Republic and the European Community are members of the WTO and consequently from 1995 are contracting parties to the GATS which states reciprocity principle. Because of it the Czech company took the VAT for refunding by the German tax office, even though there were no regulations required by the internal Czech law. As a result the National Court considered that the dispute settlement depends on the German act and is compatible with article 2 (2) of the Thirteenth Directive, stayed the proceedings and referred the following

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[11] Thirteenth Council Directive 86/560/EEC of 17 November 1986 on the harmonization of the laws of the Member States relating to turnover taxes - Arrangements for the refund of value added tax to taxable persons not established in Community territory. *OJ L 326, 21.11.1986, p. 40–41.*

[12] European Union Consolidated Versions of the Treaty on European Union and of the Treaty establishing the European Community. OJ 321 E/2, 29.12.2006.

question to the Court of Justice: “is article 2(2) of the Thirteenth Directive to be interpreted restrictively as meaning that the possibility thereby afforded the Member States formaking refunds of VAT conditional on the granting by the third States of comparable advantages regarding turnover taxes does not apply in the case of States which, as contracting parties to the GATS, may invoke the most-favourited–nation clause contained in that agreement – art. II (1) GATS”?. Consequently the National Court asked the Court of Justice the question: Should the Thirteenth Directive be interpreted only in the meaning that the Member States may receive VAT refunding if that States grant the third States comparable advantages regarding turnover taxes or does not apply to the States which are a State Party of GATS and may invoke the most- favourited- nation clause?.

In reply an answer The European Commission stated that the main aim of the Thirteenth Directive reciprocity clause is to avoid a situation where the third states company could be in more favourable situation because of the tax refunding than the European Union state company. The case occurred in 2002 and the Czech Republic was a EU Member State from the 1 st of May 2004. According to the opinion of the Commission refusal by the German tax office was according to law. This decision was not inconsistent with the most- favourited-nation clause provided by the GATS. This refusal does not put the Czech company in a less favourable position than the European Community State company. Otherwise, the refusal was in conformity with the VAT EC system and the general principle of equality. Because the Czech Republic company was not a tax payer in the light of the Thirteenth Directive it could not be treated as a less favourable one.

It is worth mentioning that in this case, according to article 23 of the Statute of the Court of Justice[13] two States, Cyprus and Republic of Poland and the Commission have given their written remarks. According to Polish Government opinion the answer on the above mentioned question should be negative. It was justified that there is not any tax provisions in the GATS. Although the GATS does not include any regulations or definition for Financial Services, the financial services are defined in the Annex which was concluded at the same time as the GATS, as a part of the Uruguay Round. The description covers insurance of all kinds, as well as banking and related services including participation in issuance of securities, underwriting, and asset management. Personally I do not agree with the Polish Government's position that the art. II(1) GATS is not relevant in this case because the rules are applied to the provision of services only, and not to the services taxation. The definition of the measures falling with the scope of the GATS is very broad. For instance Art. I (1) of the GATS says that this agreement applies to measures by Members affecting trade in services and measures by Members must be interpreted, pursuant to art. I (3)(a) of GATS as measures adopted by central, regional or local governments and authorities and by non-government bodies in the exercise of powers delegated by central, regional or local governments and authorities. Consequently the Court of Justice did not share the Polish Government's point of view.

5. SUMMARY

In light of the above consideration it is known that the judgment is unfavorable to the Czech Republic company. The Court of Justice pointed out that the most-favoured-nation clause is provided by GATS, but according to the Thirteenth Directive, Member States individually

[13] Not only the parties but also the Member States, the Commission and, where appropriate, the European Parliament, the Council and the European Central Bank are entitled to submit statements of case or written observations to the Court.

make a decision about the introduction or non-introduction of the reciprocity clause. Consequently in the case C- 335/05 the Czech Republic company could not invoke the GATS most-favoured-nation clause excepting the Thirteenth Directive provisions[14].

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