OPINION OF ADVOCATE GENERAL
STIX-HACKL
delivered on 15 December 2005 [1]

I — Introduction

1. In this case the Court is essentially required to ascertain the extent to which a foreign foundation which satisfies national requirements governing charitable status may, on account of the location of its seat, be treated less favourably than a similar domestic foundation for the purposes of direct taxation in respect of the taxation of certain domestic income.

II — Legal framework

A — *Provisions of Community law*

2. The provisions of Community law on which an interpretation is being sought are Articles 52, 58, 59, 66 and 73b of the EC Treaty.

B — *National law*

3. The relevant provisions of the German Körperschaftsteuergesetz (Law on Corporation Tax) (KStG) [2] read as follows:

'Paragraph 2: Limited tax liability

The following shall be subject to limited liability to corporation tax:

1. corporations, associations of persons and bodies of assets neither managed nor established in Germany, on their domestic income ...

1 — Original language: German.

2 — 1996 Körperschaftsteuergesetz as published on 22 February 1996 (Bundesgesetzblatt I, p. 240, Bundersteuerblatt I, p. 166).

Paragraph 5: Exemptions

(1) The following shall be exempt from corporation tax:

...

9. corporations, associations of persons and bodies of assets which, under their statutes, act of foundation or other constitution and under their *de facto* management, pursue exclusively and directly charitable, benevolent or religious objects (Paragraphs 51 to 68 of the Abgabenordnung (Tax Code)). If commercial activities are undertaken, tax exemption shall be excluded. The second sentence shall not apply to self-managed forestry activities;

...

(2) The exemptions under subparagraph 1 shall not apply to:

...

3. persons with limited tax liability within the meaning of Paragraph 2(1).

Paragraph 8: Determination of income

(1) The provisions of the Einkommensteuergesetz (Law on Income Tax) and of this Law shall determine what is to be regarded as income and the way in which income is to be determined ... .'

4. The relevant provisions of the German Einkommensteuergesetz (EStG) read as follows:

'Paragraph 21: Rental

(1) The following shall be rental income:

1. income from rental of immovable property, in particular land, buildings, parts of buildings, ...

Paragraph 49: Income subject to limited tax liability

(1) The following shall be domestic income for the purposes of limited income tax liability (Paragraph 1(4))

...

6. rental income (Paragraph 21), where the immovable property, conglomerations of property or rights are located ... in Germany ... .'

III — Facts and proceedings

5. The applicant, the Centro di Musicologia Walter Stauffer (hereinafter referred to as 'the foundation') is a foundation established under Italian law which has its seat in Italy.

6. The foundation owns commercial premises in Munich and receives rental income from those premises, on which the Finanzamt München (Munich Tax Office, hereinafter referred to as 'the defendant tax office') charged corporation tax for the 1997 tax year. The foundation does not have commercial premises of its own or a registered branch establishment in Germany. Nor does it not operate through a German subsidiary. The services in connection with the rental of the real property are provided by a German property management agent.

7. Under its statutes in the version in force for the year at issue, 1997, the foundation pursues purposes exclusively in the fields of education and training by supporting instruction in the classical methods of production of stringed instruments, the history of music and musicology in general. The foundation may endow one or more scholarships to enable Swiss young people, preferably from the city of Berne, to reside in Cremona during the entire period of instruction.

8. The reference for a preliminary ruling from the Bundesfinanzhof (Federal Finance Court, Germany) is based on the assumption that in the year at issue the foundation pursued charitable objects and satisfied the requirements with regard to company statutes for tax exemption under the first sentence of Paragraph 5(1)(9) of the KStG, whilst partial liability to tax on that income under the second and third sentences of Paragraph 5(1)(9) of the KStG did not arise, because the letting did not extend beyond property management and was not therefore a commercial activity.

9. The Bundesfinanzhof points out in particular that the promotion of the interests of the general public within the meaning of Paragraph 52 of the German Abgabenordnung (AO 1977) does not require the promotion to be undertaken for the benefit of German residents or nationals.

10. In the view of the Bundesfinanzhof, the one point which is unclear from the background provided by the first instance court is whether the foundation also satisfies the requirements as to its *de facto* management, and in particular, whether it uses the resources it receives quickly for its statutory objects, which are eligible for tax relief. The Bundesfinanzhof is considering referring the matter back to the Finanzgericht in this respect.

11. Since, because its seat and management are in Italy, the foundation receives the rental income against the background of its limited tax liability under Paragraph 49(1)(6) of the EStG in conjunction with Paragraph 21 of the EStG and Paragraphs 2(1) and 8(1) of the KStG, Paragraph 5(2)(3) of the KStG (now Paragraph 5(2)(2) of the KStG) applies, in the view of the Bundesfinanzhof; this provides that tax exemption does not apply to taxpayers with limited tax liability. The foundation would therefore be liable to pay tax on the domestic income from the rental of the commercial premises.

12. The challenge brought by the foundation against the assessment for corporation tax was rejected by the Finanzgericht München (Finance Court, Munich). The foundation thereupon lodged an appeal on a point of law with the Bundesfinanzhof, which has doubts whether the exclusion of non-resident corporations from the tax exemption under Paragraph 5(2)(3) of the KStG complies with the requirements of Community law. The Bundesfinanzhof considers that there may be a breach of the principles of freedom of establishment, freedom to provide services and/or the free movement of capital.

13. In particular, the Bundesfinanzhof takes the view that the applicability of the fundamental freedoms is not precluded in the present case by the fact that the second paragraph of Article 48 EC requires companies or firms to be 'profit-making'. In its view, this means not only the intention to maximise profits, but also any economic activity that is carried on for the purposes of profit and in exchange for a consideration. From this perspective, the rental of real property, as in the present case, could also be seen as profit-making in this sense.

14. The referring court also has doubts whether the difference in treatment between charitable foundations established in Germany and those established abroad can be justified under the cohesion principle. The cohesion principle states that tax exemption should be the correlate to the charitable objects. The charitable nature of a foreign foundation which pursues its objects abroad

may not benefit Germany. However, the Bundesfinanzhof stresses that Paragraph 52(1) of the AO 1977 does not make the recognition of charitable status for tax purposes dependent on the promotion of the interests of the general public in Germany. From that point of view, the presumed correspondence between the crediting of an advantage and tax exemption in German tax law appears not to depend on charitable status, but on whether tax liability is limited or unlimited or whether the foundation in question has its seat in Germany or abroad, which is no longer cohesive.

15. By order of 14 July 2004 the Bundesfinanzhof decided to stay the proceedings and made reference to the Court of Justice for a preliminary ruling on the following question:

'Is it contrary to Article 52 EC, in conjunction with Article 58 EC, Article 59 EC, in conjunction with Articles 66 EC and 58 EC and Article 73b EC, for a charitable foundation established under private law in another Member State, with limited liability to tax on its rental income in Germany, unlike a charitable foundation established in Germany, with unlimited liability to tax and receiving similar income, not to be entitled to exemption from corporation tax?'

IV — The question referred for a preliminary ruling

16. First of all, it is necessary to consider the discussion regarding the basic applicability of the fundamental freedoms, which is controversial because of the charitable nature of the foundation in question (A). It should then be examined which fundamental freedom should be applied in respect of income obtained from the rental of a property in a Member State other than the one in which the foundation has its seat (B). After clarifying these preliminary questions, consideration should then be given to the issue of the restriction of any fundamental freedoms that might be relevant (C). Lastly, if it is found that there is a restriction of one or more fundamental freedoms which is relevant from the point of view of Community law, possible justifications should be examined (D).

A — *The basic applicability of the fundamental freedoms*

1. Main arguments of the parties

17. The *Federal German Government* takes the view that the fundamental freedoms do not apply at all because the German tax rules on charitable institutions have a social normative content. The Court has held that

such rules are applicable to foreign Community citizens only where there is a sufficiently close connection between the Community citizen and the Member State in question, which is not the case here.

18. The defendant, the *Finanzamt München*, adds that the law governing foundations falls within the ambit of regional cultural policy, an area in which the European Union may not take harmonisation measures. The same also applies to education policy.

19. The *Chief State Solicitor of Ireland* essentially argues that the provisions of the EC Treaty which protect and guarantee the four freedoms cannot have any bearing on the effect of recognition of charitable status for tax purposes in a Member State. In addition, the application of the fundamental freedoms requires an institution to carry on activities which serve economic profit-making purposes.

20. On the other hand, the *Commission* stresses that the social policy motivation behind the tax rules at issue does not preclude the applicability of the EC Treaty. The *foundation* argues that the lack of harmonisation of charity or taxation law at Community level does not preclude the applicability of the fundamental freedoms. The Court has consistently held that the legislative powers retained by the Member States must also be exercised with due regard to the fundamental freedoms.

2. Legal assessment

21. The first point to be made is that, according to the Court's settled case-law, although direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law. [3]

22. The social policy objective of the national rules in question, which is underlined by the Federal German Government, cannot call into question the basic applicability of the fundamental freedoms either. The Commission stressed, correctly in my view, that the derogation under Paragraph 5(1)(9) of the KStG does not constitute a social advantage, but is a tax derogation introduced on social policy grounds.

3 — See in particular Case C 279/93 *Schumacker* [1995] ECR I-225, paragraph 21, and Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 19.

23. Even if, as the Federal German Government argues, the provision in question were to be classified as a social advantage — *quod non* — it should be borne in mind that the Court takes the view that Community law also applies in principle in that area. In the judgments in Cases C-120/95 [4] and C-158/96, [5] the Court held that 'in the absence of harmonisation at Community level ... it is therefore for the legislation of each Member State to determine, first, the conditions concerning the right or duty to be insured with a social security scheme ... and, second, the conditions for entitlement to benefits', but that 'the Member States must nevertheless comply with Community law when exercising those powers', with the result that the fact 'that the national rules at issue in the main proceedings fall within the sphere of social security cannot exclude the application of Articles 59 and 60 of the Treaty'. I therefore stand by the view I took in my Opinion of 12 May 2005 in Case C-512/03 *Blanckaert,* [6] according to which the categorisation of a rule as tax law or social security law does not affect the requirement to exercise powers in accordance with Community law principles.

24. An institution's contribution to the attainment of social policy objectives does not in principle preclude the applicability of Community law; the crucial factor is whether the institution carries on an economic activity. [7]

25. It must now be examined which fundamental freedom is to be applied.

B — *The relevant fundamental freedoms*

1. Main arguments of the parties

26. The *foundation* takes the view that the activity of the property management agent who manages the commercial property should be attributed to it as a permanent presence in Germany. The management of its building therefore falls within the scope of freedom of establishment. In the event that the Court does not share this view, its activity should be seen from the perspective of freedom to provide services, since it provides a cross-border service for a consideration. In any case, however, its economic activity is covered by the free move-

4 — Case C-120/95 *Decker* [1998] ECR I-1831, paragraph 22 et seq.

5 — C-158/96 *Kohll* [1998] ECR I-1931, paragraph 18 et seq.

6 — Point 65 of that Opinion (judgment of 8 September 2005 in Case C-512/03 *Blanckaert* [2005] ECR I-7685).

7 — The Court evidently took this view when, in its judgment in Case C-355/00 *Freskot* [2003] ECR I-5263, it ruled that the possible undermining of freedom to provide services on the basis of a compulsory insurance scheme may possibly be justified by the social policy objectives of that scheme. See also, most recently, the Opinion of Advocate General Poiares Maduro of 10 November 2005 in the pending Case C-205/03 P (*FENIN*) concerning the application of the concept of undertaking to organisations managing a national health system.

ment of capital, since Annex I of Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty (repealed by the Treaty of Amsterdam) [8] sets out a nomenclature of capital movements and the realisation of income is classified as a capital movement within the meaning of Point II(A), which refers to investment in real estate on national territory by non-residents. In the explanatory notes for that nomenclature, such investments are defined as purchases of buildings and land by private persons for gain or personal use.

27. The *Commission*, on the other hand, does not think that freedom to provide services is applicable. The foundation does provide a cross-border service for a consideration, but freedom to provide services is of subsidiary importance compared with the free movement of capital, which is relevant in the present case. Contrary to the view taken by the foundation, the Commission further argues that the present case does not fall within the scope *ratione materiae* of freedom of establishment, since the rental of the property in Germany does not extend beyond property management and is not therefore a commercial activity for the purposes of freedom of establishment.

28. The defendant *tax office*, the *Government of the United Kingdom* and — in the alternative — the *Federal German Government* and the *Chief State Solicitor of Ireland* claim that Article 58 of the EC Treaty (now Article 48 EC) is to be interpreted as excluding from the scope of Articles 52 and 59 of the EC Treaty (now Article 49 EC) all legal entities whose statutes specify that they are non-profit-making, irrespective of whether or not they carry on economic activities. The Government of the United Kingdom believes that its view is confirmed by the judgment in Case C-174/00 [9] and adds that the Court distanced itself from the diverging proposal made by Advocate General Cosmas in his Opinion of 28 January 1999 in Case C-172/98. [10]

29. The defendant tax office submits in this connection that the term 'profit-making' within the meaning of Article 58(2) of the EC Treaty is to be interpreted as going further than merely acting as an 'operator on the market', since it relates to the internal structure of the organisation in question. The crucial factor is whether, according to its objects and its statutes, the foundation is also geared to realising positive income. Article 58 (2) of the EC Treaty allows Member States to prevent distortions of competition which might arise where non-profit-making associations compete with undertakings.

8 — OJ 1988 L 178, p. 5

9 — C-174/00 *Kennemer* [2002] ECR I-3293

10 — C-172/98 *Commission* v *Belgium* [1999] ECR I-3999.

30. In the view of the Government of the United Kingdom, the facts of the case as described by the national court do not indicate that the free movement of capital under Article 73b of the EC Treaty is affected.

31. The *Italian Government*, on the other hand, takes the view that this case falls directly within the scope of the provisions of the EC Treaty on freedom of establishment and freedom to provide services. The contested German rules are also contrary to the principle of the free movement of capital, because legal persons not established in Germany could be deterred from investing there.

2. Legal assessment

(a) Introductory remarks

32. In its question, the German Bundesfinanzhof refers to the provisions of the Treaty concerning freedom of establishment, freedom to provide services and the free movement of capital. Since freedom to provide services is subsidiary to the other two fundamental freedoms under Article 60(1) of the EEC Treaty (now Article 50(1)EC), it is to be examined only if neither freedom of establishment nor free movement of capital is applicable in the present case.

33. With regard to freedom of establishment, it should be noted, first of all, that the parties have made detailed submissions on the interpretation of the second paragraph of Article 58 of the EC Treaty (now the second paragraph of Article 48(2) EC) in so far as that provision excludes persons governed by private law which are non-profit-making from the scope *ratione personae* of freedom of establishment, and in conjunction with Article 66 of the EC Treaty (now Article 55 EC), of freedom to provide services. It is possible, however, to clarify whether and to what extent a charitable foundation is profit-making only if the foundation's contested rental activity falls within the scope *ratione materiae* of freedom of establishment.

34. The question which must first be clarified is therefore whether the national rules at issue are to be assessed with reference to freedom of establishment and/or the free movement of capital. If the activity carried on by the foundation in Germany falls within the scope *ratione materiae* of one or both of these freedoms, it would lastly have to be considered whether the foundation belongs to the group of persons covered by the freedom in question.

(b) Differentiation between freedom of establishment and the free movement of capital

35. There is a close connection between the provisions governing freedom of establishment and those governing the free movement of capital, as can be seen from the reciprocal reservations contained in Article 48(2) of the EC Treaty (now Article 58(2) EC) and the second paragraph of Article 52 of the EC Treaty (now Article 43(2) EC).

36. The Court has addressed the differentiation between the two fundamental freedoms in a number of decisions. In its existing case-law it has taken the view that freedom of establishment and the free movement of capital apply in parallel. That case-law is based on the premise that the provisions governing the movement of capital exclude the parallel application of other fundamental freedoms only in cases where measures specifically regulate capital flows. If, however, capital flows are affected indirectly because the exercise of an economic activity in another Member State is made more difficult, the fundamental freedom applicable to the activity in question also applies in any case. [11]

37. The free movement of capital and freedom of establishment overlap in particular where national legislation concerns direct investment, for example in the form of participations, [12] or the acquisition of property with a view to carrying on a cross-border profit-making activity. [13]

38. It follows from Article 54(2)(e) of the EC Treaty (now Article 44(2)(e) EC), first of all, that freedom of establishment also covers the acquisition of commercially-used real property required for that purpose. Secondly, investment in real property constitutes a capital movement within the meaning of the nomenclature of capital movements in Annex I to Directive 88/361 and since that nomenclature still has indicative value in the Court's case-law for the purposes of defining the notion of capital movements under Article 776 et seq. of the EC Treaty (now Article 56 et seq. EC), [14] an investment in

11 — Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 34, and Case C-484/93 *Svensson and Gustavsson* [1995] ECR I-3955.

12 — See, for example, Case C-35/98 *Verkooijen* [2000] ECR I-4071, and Case C-251/98 *Baars* [2000] ECR I-2787.

13 — See, for example, Case C-302/97 *Konle* [1999] ECR I-3099. See Case C-423/98 *Albore* [2000] ECR I-5965, where the motives of the purchaser of the property were of minor importance.

14 — See Case C-222/97 *Trummer and Mayer* [1999] ECR I-1661, paragraph 21: 'inasmuch as Article 73b of the EC Treaty [now Article 56 EC] substantially reproduces the contents of Article 1 of Directive 88/361, and even though that directive was adopted on the basis of Articles 69 and 70(1) of the EEC Treaty, which have since been replaced by Article 73b et seq. of the EC Treaty, the nomenclature in respect of movements of capital annexed to Directive 88/361 still has the same indicative value, for the purposes of defining the notion of capital movements, as it did before the entry into force of Article 73b et seq., subject to the qualification, contained in the introduction to the nomenclature, that the list set out therein is not exhaustive'.

real property also falls within the scope of the free movement of capital.

39. As far as any competition between the free movement of capital and freedom of establishment is concerned, the criteria of differentiation developed by the Court may be summarised as follows:

(1) The cross-border acquisition of real property is essentially always an investment of capital, which is therefore protected under the rules governing movement of capital, irrespective of the purpose of acquisition. [15]

(2) Where the acquisition of property is necessary in order to exercise a permanent profit-making activity in another Member State, such acquisition is also protected by freedom of establishment. [16] [17]

40. Against this background, it must be examined whether the acquisition of property by a non-resident at issue in the main proceedings — on the basis of the criteria of differentiation previously set out — falls within the scope *ratione materiae* of the free movement of capital and/or freedom of establishment.

(i) Scope *ratione materiae* of the free movement of capital

41. The present case falls within the scope *ratione materiae* of the free movement of capital because the foundation, which is

15 — Case C-423/98 *Albore* (cited in footnote 13), paragraph 14. This probably supersedes in this respect the judgments in Case 63/86 *Commission* v *Italy* [1988] ECR 29 and Case 305/87 *Commission* v *Greece* [1989] ECR 1461, which concerned national rules prohibiting nationals of other Member States from acquiring real property in certain areas of the country. The Court found that such rules were in breach of the principle of freedom of establishment, but this was at a time when the Treaty provisions on free movement of capital were not yet directly applicable.

16 — Case C-302/97 *Konle* (cited in footnote 13, paragraphs 16 and 22). This was also the conclusion reached by Advocate General Alber in his Opinion in *Baars* (judgment cited in footnote 12), points 26 to 30, where the Advocate General considered direct investment and investment in real property together in that case and thus introduced the criterion of direct applicability. See also: Christoph Ohler, *Europäische Kapital- und Zahlungsverkehrsfreiheit, Artikel 56EG*, paragraphs 126 to 129; Bernadette Schäfer, *Die steuerliche Behandlung gemeinnütziger Stiftungen in grenzüberschreitenden Fällen*, 316; Jurgen Bröhmer in Christian Calliess/Matthias Ruffert (ed.): *Kommentar zu EU-Vertrag und EG-Vertrag, Artikel 56 EG*, paragraphs 22 to 25, and Randelzhofer/Forsthoff in Grabitz/Hilf, *EGV, Artikel 43 EG*, paragraphs 28 to 31.

17 — See, most recently, Case C-512/03 (cited in footnote 6), paragraph 30 et seq.: the applicant in the main proceedings in that case had acquired a holiday home abroad. The taxation of notional rental income from that property was assessed with reference to the free movement of capital, and not freedom of establishment.

established in Italy, acquired a property in Germany and the purchase of real estate on national territory by non-residents constitutes a capital movement within the meaning of Article 1 of Directive 88/361 and the nomenclature of capital movements contained in that directive. [18]

(ii) Scope *ratione materiae* of freedom of establishment

42. For freedom of establishment to apply materially in addition to the free movement of capital, the property in Germany would have to be used by the foundation as a fixed establishment in order to carry on a profit-making activity. [19]

43. It should first be stated in this connection that the real property acquired in Germany is rented out by the foundation and does not constitute an addition to an existing establishment, but is the foundation's main activity in Germany. [20]

18 — See point 38 above.

19 — In its settled case-law, the Court has defined establishment as the actual pursuit of a profit-making activity through a fixed establishment in another Member State for an indefinite period (for example Case C-221/89 *Factortame* [1991] ECR I-3905, paragraph 20).

20 — In Case C-302/97 *Konle* (cited in footnote 13), on the other hand, the plaintiff in the main proceedings planned to use the real property — a cross-border acquisition — as a principal residence in order to operate a business from there in the framework of his undertaking, which already existed in Germany

— A permanent, autonomous profit-making activity?

44. It must first be considered whether renting out a property as in the main proceedings actually constitutes a profit-making activity.

45. In its observations, the Commission stated that this is not the case because renting out a property extended no further than property management under German law and thus does not constitute an autonomous commercial activity.

46. That view cannot be shared. Renting out properties under Paragraph 14 of the AO 1977 is actually only property management and not a commercial activity. However, the interpretation of a concept of Community law cannot essentially be based on national rules. The fact that the spirit and purpose of that national provision has no connection with freedom of establishment, which is to be interpreted in the present case, also suggests that the German tax rules are not relevant.

47. Paragraph 14 of AO 1977 evidently seeks to accord tax advantages to revenue from property rental, which is generally modest

compared with revenue from a commercial activity. On the other hand, freedom of establishment seeks to protect any economic operator in the Common Market against discrimination and the scale of the economic activity in question is irrelevant unless it is a completely trivial and subsidiary activity. The broader the interpretation of the notion of profit-making activity in Community law, the larger the group of persons covered, with the result that the Court's broad interpretation of the concept of profit-making activity is not surprising against this background. [21]

48. Legal persons which, as in the present case, do not seek to maximise their profits, may also therefore carry on a profit-making activity. [22] Even though, as a charitable foundation, the foundation may not seek to maximise its profits in renting out the property, its rental activity is an activity for a consideration and thus constitutes participation in economic life, which is not completely insignificant. As a result, renting out the property in Munich is an autonomous profit-making activity for the purposes of freedom of establishment.

49. The criterion of permanence is thus also satisfied.

— Existence of a fixed establishment?

50. The foundation does not have commercial premises of its own, or therefore a fixed establishment, in Germany. The services in connection with the rental of the property are, according to the documents before the Court, provided by a German property management agent. The question therefore arises whether the activity of the property management agent may be attributed to the foundation as a permanent presence.

51. In the 'insurance case' [23] the Court held that that an undertaking is to be regarded as established even if its presence in another Member State consists merely of an office managed by a person who is independent but authorised to act on a permanent basis for the undertaking, as would be the case with an agency.

52. However, in such cases there must be an exclusive or predominant link between such an independent person and his contractor, with the result that the person in question is involved in concluding contracts and does not at the same time act on behalf of competing firms. Only if the independent person restricts his own managerial freedom in this way is the contractor represented by

21 — See, for example, Case 36/74 *Walrave and Koch* [1974] ECR 1405, paragraph 4.

22 — Case 221/85 *Commission* v *Belgium* [1987] ECR 719, and Case C-70/95 *Sodemare and Others* [1997] ECR I-3395.

23 — Case 205/84 *Commission* v *Germany* [1986] ECR 3755, paragraph 21.

him to be regarded as established in the host country. [24]

53. The Court has not had the opportunity to apply these attribution criteria to other cases, possibly because of the particular nature of insurance sales, [25] and its general validity could therefore appear doubtful.

54. Irrespective of this, it must be stated that in any case a property management agent acts for a large number of owners and does not therefore satisfy the abovementioned attribution criteria, with the result that it is not possible to attribute the property management agent's activity to the foundation.

55. Consequently, freedom of establishment does not apply in the present case because the foundation does not have a fixed establishment in Germany.

24 — See in this regard the arguments made by Tiedje and Troberg in: von der Groeben and Schwarze, *Artikel 43 EG*, paragraphs 44 to 46, and by Randelzhofer and Forsthoff in: Grabitz and Hilf, *Artikel 43 EG*, paragraph 59 with further references.

25 — Unlike in other economic sectors, insurance brokers generally play a key part in designing the insurance product,

(c) The scope *ratione personae* of the free movement of capital

56. Nevertheless, the applicability of the Treaty provisions on the free movement of capital still depends on whether, as a charitable foundation established under Italian law, the foundation falls within the scope *ratione personae* of those provisions. The answer to this question is in turn dependent on the extent to which a charitable foundation like the foundation belongs to the group of persons covered by the free movement of capital.

57. Notwithstanding the classification of the rental activity in the individual case under Community law, a foundation could be excluded from the scope *ratione personae* of the free movement of capital. This could follow, for example, from a possible *mutatis mutandis* application of Article 48(2) EC, in particular if it is possible to infer from the foundation's charitable nature that it is non-profit-making.

58. In accordance with its wording, Article 48 EC is applicable to the chapter of the EC Treaty on freedom of establishment. Article 48 EC is also applicable to freedom to provide services by virtue of the reference contained in Article 55 EC. However, the Treaty provisions on the free

movement of capital do not contain any such reference. The wording and the scheme of the EC Treaty therefore suggest that the scope *ratione personae* of the free movement of capital is not subject to the restrictions under Article 48(2) EC.

59. The resulting non-application of Article 48 EC with regard to the free movement of capital is consistent with the nature of this fundamental freedom, which is object-related and not personal. The effectiveness of the free movement of capital has no connection with the person of those involved.

60. In my view, in a more recent judgment the Court of Justice applied the properties of the free movement of capital as an object-related freedom. In the judgment in Case C-364/01 [26] concerning inheritance duty in the Netherlands in a case where the person whose estate was subject to probate had transferred his residence from the Netherlands to Belgium for non-economic reasons in order subsequently to acquire properties in the Netherlands, the referring court essentially asked inter alia whether the applicability of the free movement of capital depended on the existence of cross-border economic activity. The Court merely found that investments in property and acquisition of property through inheritance fall within the scope of the free movement of capital, without considering the persons who rely on the freedom.

61. It must therefore be stated that the main proceedings fall within the scope *ratione personae* of the free movement of capital irrespective of whether or not the foundation is profit-making within the meaning of Article 48(2) EC.

C — *The existence of a restriction on the free movement of capital*

1. Main arguments of the parties

62. The *Commission*, the *Italian Government* and the *foundation* take the view that the free movement of capital is restricted because the Italian foundation is treated less favourably than a comparable charitable foundation having its seat in Germany. The foundations are comparable because both

26 — Case C-364/01 *Erben von Barbier* [2003] ECR I-15013.

foundations were treated in an identical manner in all fiscal aspects other than consideration of the tax advantage.

63. The *Commission* argues that if the Italian foundation had its seat in Germany, its rental income would be exempt from corporation tax. It is denied that advantage only because it has its seat in Italy and is therefore subject to limited tax liability in Germany. The consequence of this indirect restriction is that legal persons having their seat in another Member State are deterred from investing their capital in Germany.

64. The *Government of the United Kingdom*, on the other hand, claims that foundations recognised as having charitable status under Italian law would not be placed in a comparable situation with foundations recognised as having charitable status under German law because there are different requirements governing charitable status in each Member State.

65. The *German Government* adds that the differences in the national legal orders could be used by Member States as a pretext for making differentiations in law which cannot be challenged under Community law. Furthermore, only domestic charitable foundations are integrated in the social life of the host State, which represents an objective difference compared with foreign charitable foundations.

66. In the view of the defendant *tax office*, the taxation of the foundation does not constitute an obstacle preventing it from investing in the Federal Republic, since taxation of income is the general rule in all the Member States.

67. The *foundation* also states that according to the most-favoured nation clause the favourable tax rules contained in the Double Taxation Convention with the United States are applicable to it, otherwise its freedom to move capital would be restricted. The restriction lies in the fact that in Germany the Italian foundation is in a comparable situation to an American charitable foundation which receives rental income in Germany and is treated less favourably for purposes of taxation than the US foundation, which is not taxed.

2. Legal assessment

(a) The system of free movement of capital

68. In the present case it must be considered whether the taxation of a charitable founda-

tion from another Member State which is subject to limited tax liability constitutes a restriction on the free movement of capital.

69. The free movement of capital in any case differs from the other fundamental freedoms in its formulation in so far as, under the wording of Article 56 EC, it includes a general prohibition on imposing restrictions, and makes the distinction that this prohibition is without prejudice to the Member States' right to apply provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested (Article 73d(1)(a) of the EC Treaty, now Article 58(1)(a) EC).

70. However, this does not mean, according to the Court's case-law, that the Member States may restrict the scope of the free movement of capital more heavily than the scope of the other fundamental freedoms.

71. The Court did not have the opportunity to examine the fundamental legislative competence of the Member States in the field of direct taxation in the light of Articles 56 EC and 58 EC until the judgment in *Manninen*.[27] In that judgment it held that Article 58 EC permits tax legislation making a distinction between taxpayers by reference to the place where they invest their capital only where the distinction made takes account of a difference that actually exists or where the differentiation between comparable situations appears to be justified by overriding reasons in the general interest and that such justification requires that the difference in treatment in question may not go beyond what is necessary in order to attain the objective of the legislation, with the result that a distinction must be made between unequal treatment which is permitted under Article 58(1)(a) EC and arbitrary discrimination which is prohibited by Article 58(3) EC.

72. Although these arguments seemed to suggest that the Court applied the same principles to the free movement of capital as to the other fundamental freedoms, this parallelism was only clearly shown in the judgment of 5 July 2005 in the case of *D*,[28] where the Court applied to the free movement of capital its case-law concerning restrictions on freedom of movement, freedom of establishment and freedom to provide services in the field of direct taxation.

73. This case-law must now be examined. According to the case-law, the fundamental freedoms prohibit not only overt discrimination on grounds of nationality, but also all covert forms of discrimination which, by the

27 — Cited in footnote 3.

28 — Case C-376/03 *D* [2005] ECR I-5821.

application of other criteria of differentiation, lead in fact to the same result. They therefore contain a prohibition of discrimination, which is intended to prevent different rules from being applied to comparable situations or the same rules from being applied to different situations without justification.

74. With regard to a possible differentiation between residents and non-residents in national taxation law, the Court has stressed that there is a risk that a Member State's legislation which reserves tax advantages for residents will have a detrimental effect primarily on the nationals of other Member States, since non-residents are mainly foreign nationals, with the result that such legislation may constitute indirect discrimination on grounds of nationality.

75. First of all, the Court has found, in cases relating to income taxation on natural persons, [29] that persons resident in a certain State and non-residents are not generally in a similar situation because there are objective differences between them from the point of view both of the source of their income and of their personal ability to pay tax or their personal and family circumstances.

76. However, in the case of a tax advantage which is not available to a non-resident, a difference in treatment as between the two categories of taxpayer may constitute discrimination within the meaning of the Treaty where there is no objective difference between the situations of the two groups such as to justify different treatment in that regard.

77. The existence of such an objective difference is to be assessed above all on the basis of whether the non-national in question receives the majority of his income in the State of employment or in the State of residence. [30]

(b) The restriction on the free movement of capital in the main proceedings

78. In German law, charitable corporations are exempt from corporation tax under the first sentence of Paragraph 5(1)(9) of the KStG. Under Paragraph 5(2), however, such exemption does not apply to corporations

29 — With regard to direct taxation, the Court's case-law deals with both natural and legal persons. The case-law on both groups generally follows the same principles, although there are some substantive differences which also have implications for the legal treatment of the two groups, such as the link between residence and the applicable law (see Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 18 *'avoir fiscal'*.

30 — See *Schumacker* (cited in footnote 3).

with limited tax liability. Under Paragraph 2(1) of the KStG, limited liability to corporation tax on domestic income applies to corporations neither managed nor established in Germany. This means that foreign charitable corporations which obtain their income in Germany, as in the present case, unlike a domestic charitable corporation, are not exempt from corporation tax in respect of that income.

79. Consequently, a foreign charitable corporation is treated less favourably than a domestic charitable corporation. These provisions are not based directly on the seat of the foundation, but on the limited tax liability. However, this criterion leads indirectly to the same result by virtue of Paragraph 2(1) of the KStG. If the charitable foundation had its seat in Germany and not in another Member State, it would be subject to unlimited tax liability and its income from the rental of its property would be exempt from corporation tax. It is not granted that advantage merely because it has its seat in another European country and is therefore subject to limited tax liability.

80. The national tax legislation in question does not directly concern the investments covered by the scope of the free movement of capital in the form of investments in real property in another Member State. However, the purpose of an investment is to derive benefits — in this case in the form of rental income. As a result of the less favourable taxation of rental income obtained by an institution having its seat abroad — based on its limited tax liability — the legislation in question consequently worsens the environment for investment by foreign investors compared with similar investments by a domestic corporation. This is therefore an indirect restriction on the free movement of capital, which is nevertheless sufficient, as the Court has held, to accept the existence of a restriction on the free movement of capital. [31]

D — *The existence of arbitrary discrimination*

1. Main arguments of the parties

81. In the view of the *foundation*, the criterion of differentiation based on limited tax liability is liable to have particularly detrimental effects on legal persons having their seat in other Member States. The resulting discrimination is not justified.

31 — See Case C-35/98 *Verkooijen* (cited in footnote 12), paragraph 34 et seq.

Furthermore, the less favourable tax treatment of rental income obtained by a charitable foundation with limited tax liability in Germany is likely to make an investment in German property with a view to rental much less attractive than an investment in Italian property.

82. Lastly, the foundation argues that Germany has concluded double taxation conventions with two Member States, France and Sweden, which grant non-resident charitable corporations special advantages — exemption from estate, inheritance and gift tax. Germany has also concluded a convention with the United States which provides for an exemption from income tax. In this respect the foundation points out, on the basis of the Court's judgment in Case C-307/97, [32] that any financial disadvantages that Germany suffers as a result of granting an income tax exemption, provided for in the US-German convention, could not justify encroachment on the fundamental freedoms.

83. The defendant *tax office*, on the other hand, takes the view that the refusal to grant tax exemption for a foundation with limited tax liability is not contrary to Community law. First of all, the tax advantage granted to a charitable foundation is offset by the reduced pressure on public finances. Usually, however, the work of charitable organisations having their seats outside Germany is concentrated on other countries and does not reduce pressure on the German public budget. Secondly, persons subject to limited tax liability and persons subject to unlimited tax liability are not in a comparable situation in respect of direct taxation. Lastly, the German financial authorities are able only to a limited extent to verify whether a charitable foundation established abroad actually fulfils the objects laid down in its statutes.

84. In the view of the *German Government*, the German rules do not discriminate against foreign corporations; if a case of discrimination or a restriction did exist, however, it would be justified on grounds of cohesion, since there is a strict reciprocity between tax exemption and the tax substitute in the form of the activities performed in the public interest by charitable corporations with unlimited tax liability.

85. In the view of the *United Kingdom Government*, a breach of the principle of the free movement of capital is ruled out because the requirements governing charitable status differ from one Member State to the next according to the conception of public interest and public policy in that State,

32 — Case C-307/97 [1999] ECR I-6161.

with the result that domestic and foreign foundations are not in a comparable situation. In any case, the refusal to grant tax exemption to a foundation that is non-profit-making and has its seat in another Member State is justified by the need to guarantee the effectiveness of fiscal supervision.

86. In the view of the *Commission*, however, the difference in treatment cannot be justified. First of all, there is no objective difference between a charitable foundation with its seat in Germany and a charitable foundation with its seat in another Member State. Secondly, the German financial authorities are able to obtain any information that may be needed to assess corporation tax from the competent authorities of other Member States pursuant to Directive 77/799/EEC. [33]

87. Fiscal supervision can be achieved through less restrictive measures and the provisions which favour charitable organisations in the conventions with France and the United States show that the German legislature certainly considers tax incentives for charitable activities outside the Federal Republic to be consistent with the overall system.

2. Legal assessment

88. Consideration must be given below to the extent to which domestic and foreign foundations are in a comparable situation. If there were comparable, it would then have to be considered whether the difference in the treatment of domestic and foreign foundations under the German Körperschaftsteuergesetz, which has already been established, may be justified by overriding reasons in the general interest. [34]

(a) Comparability of domestic and foreign foundations

89. The abovementioned difference in treatment is discriminatory if a domestic foundation and a foundation which has its seat in another Member State are in a comparable situation in respect of the German tax rules.

33 — Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums (OJ 1977 L 336, p. 15), as amended by Council Directive 2004/106/EG of 16 November 2004 (OJ 2004 L 359, p. 30, hereinafter 'the Mutual Assistance Directive').

34 — With regard to the system of the free movement of capital reference is made to Case C-319/02 *Manninen* (cited in footnote 3), paragraphs 28 and 29.

90. Under German law charitable foundations are exempt from corporation tax. The Government of the United Kingdom has argued with regard to those rules that a foreign foundation which carries on its charitable activities mainly abroad, unlike a domestic foundation which performs charitable work in Germany, is not a charitable foundation within the meaning of national law. Consequently, domestic and foreign charitable foundations are not in a comparable situation.

91. It is not possible to concur with this view. It is for national law, which must be interpreted by national courts, to determine whether a foundation is regarded as charitable in Germany. In this regard, the Bundesfinanzhof clearly stated in its order for reference that 'German tax law recognises the pursuit of charitable aims irrespective of whether this is undertaken in Germany or abroad. The promotion of the "interests of the general public" for the purposes of Paragraph 52 of the AO 1977 does not require that the promotion be undertaken for the benefit of German residents or nationals.'

92. However, a foreign foundation which pursues its charitable aims abroad is to be regarded as charitable under German law in exactly the same way as a domestic foundation which performs charitable work in Germany. It follows that the contested tax treatment of that foreign foundation, whose charitable nature is not at issue under national law, may be compared with the treatment of a domestic charitable foundation.

93. In this connection, it is also interesting to note that in the Double Taxation Convention with the United States, the German State also granted tax exemption to charitable foundations established in the United States and therefore subject to limited tax liability. This shows that German law does not preclude, at least in principle, 'automatic' recognition of charitable status granted abroad.

94. It should nevertheless be stressed that this equal treatment — under national legislation — of domestic and foreign foundations in respect of recognition of charitable status cannot be regarded as a requirement of Community law. It is for national law to determine the interests that it considers should be recognised as charitable without a decision by another Member State having indicative value. The supra-national assessment of the general interest favoured by the Commission seems to be particularly bold in non-economic spheres in particular,

in view of the Community's fragmentary legislative powers. [35]

95. In addition, the Government of the United Kingdom and the tax office have rightly pointed out the need for supervision, in particular regarding the use of donations received and other income in accordance with the statutes.

96. The recognition of the Member States' fundamental discretion in recognising charitable status combined with the need for effective supervision of the organs and the activity of an institution which pursues charitable objects in accordance with its statutes generally require recognition of an institution's charitable status to be based on a sufficiently clear domestic connection. It would therefore be compatible with Community law in principle to refuse to recognise the charitable status of such an institution where its activities have no such domestic connection, as is apparent in the present case. Where national law does not have regard to this domestic connection for the foundation's activity — as can be inferred from the — evidently undisputed — statements made by the referring court, Community law essentially precludes a distinction between charitable institutions based simply on their seat because this constitutes discrimination between *comparable* establishments.

97. Finally, it must be considered whether the less favourable treatment which the foundation claims to suffer compared with charitable foundations having their seat in the United States is relevant from the point of view of Community law.

98. In the case of *D* [36] the Court found that a non-resident and another non-resident who enjoyed special treatment on the basis of a convention for the avoidance of double taxation were not comparable. In its grounds it stated that 'the fact that those reciprocal rights and obligations apply only to persons resident in one of the two Contracting Member States is an inherent consequence of bilateral double taxation conventions.' [37] The most-favoured nation clause on which the foundation relies cannot therefore be applicable in the present case because the tax situation of a US charitable foundation and

35 — The reference to the Communication from the Commission on services of general interest in Europe of 20 September 2000, COM(2000) 580 fina (OJ 2001, C 17, p. 4) is mistaken because the Treaty makes a fundamental distinction between services of general *economic* interest (see, for example, Article 86(2) EC) and non-economic activities.

36 — Cited in footnote 28.

37 — Cited above, paragraph 61.

of a charitable foundation with its seat in Italy are not comparable.

99. As an intermediate conclusion, it should nevertheless be stated that the rules in question appear to be discriminatory in so far as they subject comparable taxpayers to different treatment. Consideration must now be given to possible justifications.

(b) The coherence of the German tax rules

100. It should first be stated that the parties evidently have a different understanding of the 'cohesion' of a tax system. The Federal German Government interprets the cohesion relationship very broadly as the grant of a tax advantage to foundations which ease the burden on the State through their domestic charitable objects. On the other hand, the foundation sees cohesion only as offsetting a tax disadvantage suffered by the taxpayer with a tax advantage.

101. In *Bachmann*[38] and *Commission* v *Belgium*,[39] the Court stated that the need to ensure the cohesion of tax rules can justify a restriction on the fundamental freedoms.

102. In subsequent judgments, however, the Court restricted the scope of this principle. In *Asscher*[40] and *Verkooijen*,[41] for example, the Court held that tax rules can be regarded as cohesive only if there is a compelling direct link between the tax advantage granted, on the one hand, and taxation, on the other, for the same taxpayer in respect of the same tax. Those judgments therefore require a strict functional connection between tax advantages and tax disadvantages. It is not sufficient for the compensatory effect to be a coincidental consequence.

103. In *Verkooijen* the Court rejected the assumption of the cohesion of the tax rules at issue in that case on the ground that in that case 'no such direct link exists in this case between the grant to shareholders residing in the Netherlands of income tax exemption in respect of dividends received and taxation of the profits of companies with their seat in another Member State. They are two separate taxes levied on different taxpayers.'[42]

38 — Cited in footnote 11.

39 — Case C-300/90 [1992] ECR I-305.

40 — Case C-107/94 *Asscher* [1996] ECR I-3089.

41 — Judgment cited in footnote 12.

42 — Cited above, paragraph 58.

104. Against this background, the interpretation of the notion of cohesion favoured in particular by the German Government, according to which the tax rules in question are to be regarded as cohesive because they favour — domestic — institutions which, through their charitable objects, ease the burden on the State with regard to services of general interest in Germany, is not persuasive.

105. In a situation like the one in the main proceedings, cohesion must instead be seen as offsetting a tax advantage and a tax disadvantage. It is not clear in the present case which advantage the disadvantage in question suffered by institutions with limited tax liability under Paragraph 5(2)(2) of the KStG is intended to offset.

106. However, even a broad interpretation of the notion of cohesion would not allow any justification of the restriction established. If we take the approach of the German Government, according to which preferential treatment should be given only to charitable institutions which, through their charitable activities, ease the burden on the State — on the basis of a domestic connection for their activities –differentiated tax treatment could appear to be cohesive only where preferential treatment is based on that domestic connection for their charitable activities — and not their seat. According to the referring court, however, the tax rules in question are not based on the place where the charitable activity is performed.

107. In summary, it should therefore be stated that the tax rules in question cannot be described as cohesive under either a narrow or a broad interpretation of the cohesion principle.

(c) The lack of adequate means of supervision and verification

108. The tax office and the German Government, supported in this respect by the Government of the United Kingdom and the Chief State Solicitor of Ireland, suggest that German authorities do not have adequate means of supervision and verification with regard to foreign foundations. Problems may arise in particular because the German fiscal administration may not restrict the verification only to the foundation's activity that is relevant for tax purposes, but must, in order to establish that the foundation has acquired and retained charitable status, be able to conduct a thorough check on all the foundation's activities.

109. The practical difficulties that accompany a thorough verification of foundations which pursue cross-border activities cannot be denied. The necessity — indeed the indispensability — of such means of supervision and verification are undisputed in the light of growing concerns over public safety.

110. However, this argument fails to recognise that in the main proceedings the Bundesfinanzhof does not express any doubts as to the foundation's charitable status and therefore evidently takes the view the German financial authorities' means of verification are sufficient. [43]

111. In its case-law the Court states that the effectiveness of fiscal control may in principle justify an infringement of fundamental freedoms, but in most cases rejects such a justification with reference to existing means of mutual assistance. [44] [45]

112. With reference to the Mutual Assistance Directive, the Court has ruled on several occasions that a Member State is in a position to verify whether the conditions laid down in the relevant tax rules have been met. [46]

113. In any case, however, the abovementioned difficulties concern the recognition of the charitable status of a foundation with its seat abroad and do not justify for tax purposes any discrimination against foundations whose charitable status is not in doubt. As a result, the exclusion of charitable foundations with limited tax liability from tax exemption cannot be justified on grounds of effective fiscal supervision either.

(d) Other possible justifications

114. It is not possible either to concur with the argument made by the Chief State

43 — As is also shown by the grant of a similar tax exemption for foreign foundations in the double taxation conventions concluded with the United States on the one hand and France on the other.

44 — Particular mention should be made of the Mutual Assistance Directive (cited in footnote 33).

45 — See, for example, Case C-422/01 *Skandia and Ramstedt* [2003] ECR I-6817, paragraph 42 et seq.

46 — Case C-422/01 *Skandia and Ramstedt*, cited above, paragraph 42 et seq., with further references.

Solicitor of Ireland that the difference in treatment is justified on grounds of prevention of tax abuse.

115. The prevention of abuse and tax evasion do constitute a recognised justification. However, since in this case such a presumption of abuse is based only on the foreign connection and generally excludes all foreign foundations from the tax advantage, as the Commission rightly observes in its observations, it is in any case clearly to be regarded as disproportionate.

116. The German Government, the Government of the United Kingdom and the Chief State Solicitor of Ireland lastly rely on considerations of reciprocity, potential losses of tax revenue and the possibility of avoiding the discrimination at issue.

117. With regard to the risk of loss of tax revenue, the Court has stated, in *Verkooijen* for example, that the reduction in tax revenue 'cannot be regarded as an overriding reason in the public interest.' [47]

118. In its *'avoir fiscal'* judgment [48] the Court held with regard to the reciprocity argument that the fundamental freedoms apply unconditionally and, in particular, do not permit the rights based on them to be made subject to a condition of reciprocity imposed for the purpose of obtaining corresponding advantages in other Member States.

119. With regard to the supposed possibility of avoiding the discrimination in question — for example by relocating — the Court ruled, in the same judgment, that the fundamental freedoms 'expressly [leave] traders free to choose the appropriate legal form in which to pursue their activities in another Member State ...' [49]

120. In summary it must be stated that national rules of the kind at issue, under which a tax exemption is denied to institutions whose charitable status is recognised under national law, but which are subject to limited tax liability because their seat is abroad, constitute an unjustifiable restriction on the free movement of capital.

47 — Judgment cited in footnote 12, paragraph 59.

48 — Cited above in footnote 29.

49 — Cited above, paragraph 22.

V — Conclusion

121. It is therefore suggested that the question referred by the Bundesfinanzhof be answered as follows:

Articles 736 and 73d of the EC Treaty (now Articles 56 EC and 58 EC) on the free movement of capital in the Community preclude national rules under which a charitable foundation — recognised under national law — established under private law in another Member State, with limited liability to tax on its rental income in Germany, unlike a charitable foundation established in Germany, with unlimited liability to tax and receiving similar income, is not entitled to exemption from corporation tax.

Articles 736 and 73d of the EC Treaty (now Articles 56 EC and 58 EC) on the free movement of capital in the Community do not preclude national rules which treat institutions having their seat abroad, whose charitable status is not recognised under national law, differently from charitable institutions having their seat in Germany.