JUDGMENT OF THE COURT (Second Chamber)

18 December 2007 *

In Case C-436/06,

REFERENCE for a preliminary ruling under Article 234 EC, from the Finanzgericht Hamburg (Germany), made by decision of 20 September 2006, received at the Court on 23 October 2006, in the proceedings

Per Grønfeldt

Tatiana Grønfeldt

v

Finanzamt Hamburg — Am Tierpark,

THE COURT (Second Chamber),

composed of C.W.A. Timmermans (Rapporteur), President of the Chamber, L. Bay Larsen, K. Schiemann, P. Kūris and C. Toader, Judges,

* Language of the case: German.

Advocate General: D. Ruiz-Jarabo Colomer,
Registrar: M. Ferreira, Principal Administrator,

having regard to the written procedure and further to the hearing on 27 September 2007,

after considering the observations submitted on behalf of:

— Mr and Mrs Grønfeldt, by A. Mutscher, tax advisor,

— the Finanzamt Hamburg — Am Tierpark, by B. Fiedler, advisor,

— the German Government, by M. Lumma and C. Blaschke, acting as Agents,

— the Greek Government, by K. Georgiadis, O. Patsopoulou and I. Pouli, acting as Agents,

— the Commission of the European Communities, by R. Lyal and G. Wilms, acting as Agents,

having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Article 56 EC.

2 The reference was made in the context of proceedings between Mr and Mrs Grønfeldt and the Finanzamt Hamburg — Am Tierpark ('the Finanzamt') concerning the taxation in Germany of profits made from the sale of shares in two limited companies governed by Danish law.

National legal context

3 As is apparent from the order for reference, Paragraph 17 of the Law on income tax (Einkommensteuergesetz), in the version resulting from the law of 24 March 1999 (BGBl. 1999 I, p. 402), profits made on the sale of shares in a limited company were included, inter alia, under the term 'business income' if the seller had held, either directly or indirectly, a substantial share of the company's capital, that is to say at least 10%, within the last five years.

4 Under Paragraph 17 of the Law on income tax, as amended by the Law on tax reduction 2001/2002 (Steuersenkungsgesetz 2001/2002), of 23 October 2000 (BGBl. 2000 I, p. 1433; 'the new version of the EStG'), the term 'business income' also encompassed profit made on the sale of shares in a limited company if the seller had held, either directly or indirectly, at least a 1% share of the company's capital within the last five years.

5 It is apparent from the provisions for the implementation of Paragraph 17 of the new version of the EStG, namely Paragraphs 52(1) of the new version of the EStG and 52(34)(a) of the Law on income tax, as amended by the Law aligning tax laws with the Euro (Steuer-Euroglättungsgesetz) of 19 December 2000 (BGBl. 2000 I, p. 1790), that where, in the case of the sale of shares in companies which are not subject to unlimited corporation tax, and thus in particular of shareholdings in a foreign limited company, the new version of Paragraph 17 of the EStG was applicable from the financial year 2001, irrespective of further conditions. For shareholdings in companies subject to unlimited corporation tax, which is the rule for companies governed by German law, the new version of Paragraph 17 of the EStG was applicable only from the tax year 2002 and profits from sales made during 2001 were thus taxable only if the seller had held a shareholding of at least 10% of the company capital.

The main proceedings and the question referred

6 The order for reference indicates that Mr Grønfeldt held a shareholding in the capital of two companies governed by Danish law, namely Navision Software A/S and WISEhouse Denmark A/S, in the amount of 2.1% and 2.5% respectively.

7 In 2001 he sold a large part of those shareholdings. In so doing, he made a profit on the sale of the shares which he held in Navision Software A/S and a small loss on the shares held in WISEhouse Denmark A/S.

8 In the income tax notice of 10 April 2003, the Finanzamt, after balancing the profit and loss made from the sale of those shares, took into account a sale profit of DEM 2 021 287, in accordance with the new version of Paragraph 17 of the EStG. The subsequent administrative appeal brought by Mr and Mrs Grønfeldt against that assessment was unsuccessful.

9 Mr and Mrs Grønfeldt thus challenged that assessment before the national court.

10 In their view, taxing the profits made from the sale of the shares held in a foreign limited company when the share of the capital of that company amounts to at least 1%, and taxing those made from the sale of shares held in a German limited company when the share of the company capital amounts to 10%, constitutes a difference in treatment which infringes, inter alia, the principle of the free movement of capital under Article 56 EC.

11 The national court endorses the doubts raised by the Bundesfinanzhof (Federal Finance Court) (Germany) in order VIII B 107/04 of 14 February 2006 on the compatibility of Paragraph 17 of the new version of the EStG with the principle of the free movement of capital.

12 Taking the view that the resolution of the dispute before it requires an interpretation of Community law, the Finanzgericht (Finance Court) Hamburg (Germany) decided to stay the proceedings and to refer the following question to the Court for a preliminary ruling:

'Is it compatible with Article 56 [EC], on the free movement of capital, that the profits from a sale of shares in a foreign limited company in 2001 were subject to tax if the seller held, either directly or indirectly, a share of at least 1% of the company's capital within the previous five years, whereas the profits from the sale of shares in a (national) limited company subject to unlimited corporation tax in 2001 were, in otherwise comparable circumstances, subject to tax only in the case of a substantial shareholding of at least 10%?'

The question referred

13 As is apparent from the order for reference, in 2001, the profits from sales of shares in foreign limited companies were taxable as soon as the shareholding in the company capital amounted to 1%. For that same year, on the contrary, and in identical circumstances furthermore, the profits from sales of shares in limited companies governed by national law were taxable only when that shareholding amounted to 10%.

14 Such a difference in treatment on the basis of the place of investment of the capital has the effect of discouraging a shareholder from investing his capital in a company established in another State and also has a restrictive effect on companies

established in other States in that it constitutes an obstacle to their raising capital in Germany (see, to that effect, Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, paragraph 166).

15 It is insignificant, in that regard, that the difference in treatment existed only for a limited period of time. That fact alone does not preclude the difference in treatment from having significant effects — as indeed shown in the facts in the main proceedings — or, therefore, from giving rise to a genuine obstacle to the free movement of capital.

16 In order for such a difference in treatment to be compatible with the provisions of the EC Treaty on the free movement of capital, it must concern situations which are not objectively comparable or be justified by an overriding reason of public interest (*Test Claimants in the FII Group Litigation*, paragraph 167).

17 According to the Finanzamt and the German Government, the difference in treatment at issue in the main proceedings is part of a provisional system, for the setting-up of which a Member State should be granted a certain amount of leeway, seeking, in the long term, to bring the German corporate tax system into line with Community law and to remove any possible discrimination. More specifically, so that an identical tax burden is applicable to investments made in Germany and those made abroad, in the German corporate tax system the full deduction procedure was replaced by the 50% income-reduction procedure.

18 As regards the full deduction procedure, according to the German Government, a limited company was taxed, as a rule, at a rate of 40%. The profits which it distributed to its shareholders were taxed at a rate of only 30%. The shareholder had to pay income tax again on the profits distributed on the basis of his personal tax rate. He was, however, able to deduct from his personal tax debt the total amount of the corporation tax already paid in Germany by the limited company. Double taxation was thereby avoided.

19 By contrast, as regards the 50% income-reduction procedure, according to the German Government, limited companies are now taxed on their profits for financial years beginning after 31 December 2000 only at the uniform rate of 25%, regardless of whether they distribute the profits made or not to their shareholders. A shareholder who receives a dividend can no longer deduct corporation tax. However, he henceforth has to declare only half of the dividends as capital income, the other half being tax exempt. That system applies in parallel to the taxation of dividends and profits from share sales.

20 The German Government also contends that, in the context of the 50% income-reduction procedure, the full taxation of the profits of a limited company is possible, contrary to the case of the full deduction procedure, in which the full taxation takes place already at the company level, only by combining the taxation of profits at the company level and the taxation of half of the dividends at the shareholder level.

21 That combination, which ensures, in the view of the German Government, complete taxation, would be disrupted if the percentage of the shareholding of the company capital, which gives rise to tax liability in the case of share sales, were to remain fixed

at 10%, without amendment. In that case, a shareholder with a shareholding of at least 10% could actually sell it free of tax, in a case where the company has been retaining non-distributed profits for several years.

22 The Finanzamt and the German Government point out, in addition, that it is, in principle, as from 2001 that the new system linked to the 50% income-reduction procedure came into force for companies which distribute profits. However, at the shareholder level, the full deduction procedure was still applicable in 2001 if the dividend income arose from ordinary profit distributions from a resident company for the year 2000. By contrast, for beneficiaries of foreign dividends, the 50% income-reduction procedure was applied without a transitional phase, as those beneficiaries had not benefited, under the previously applicable law, from the full deduction procedure.

23 In that regard, in relation to the question whether a difference in treatment, such as that at issue in the main proceedings, concerns situations which are objectively comparable, it is necessary to compare the situation in which a shareholder with shares in a non-resident company found himself in 2001 with that in which a shareholder with shares in a resident company found himself in that same year. Thus, contrary to the German Government's contentions, a comparison between the situation in which a shareholder with shares in a non-resident company found himself prior to 2001 and the — allegedly more favourable — situation in which he found himself as from that year is not relevant.

24 Given that the 50% income-reduction procedure was introduced precisely, in the words of the German Government itself, to remove any possible discrimination between investments in resident companies and investments in non-resident

companies, it appears quite clear that the shareholders of those two categories of company, in relation to the application of a taxation threshold in a situation such as the one in the case in the main proceedings, are in an objectively comparable situation.

25 It is therefore necessary to examine whether a difference in treatment, such as that at issue in the main proceedings, is justified by an overriding reason of public interest.

26 As regards, first, the argument concerning the need to ensure full taxation, it should be that that argument is similar to an argument based on the coherence of the tax system.

27 As also pointed out by the aforementioned Bundesfinanzhof in its order VIII B 107/04, to which the national court makes reference, a difference in treatment, such as that at issue in the main proceedings, does not appear to be justified by the need to ensure the coherence of the tax system, since no direct link has been established, for a shareholder, such as Mr Grønfeldt, between the tax advantage concerned and the offsetting of that advantage by a particular tax levy (see, to that effect, Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 42, and Case C-292/04 *Meilicke and Others* [2007] ECR I-1835, paragraph 26).

28 In addition, it is true that the argument concerning full taxation makes it possible to understand the reason why the new system linked to the 50% income-reduction procedure was not introduced until 2002 for shareholders with shares in a resident company. Since that type of company was still subject in 2000 to tax on profits under the old procedure of full deduction, 'full taxation', as envisaged by the German

Government, therefore did take place in relation to dividends paid in 2001. However, that same argument cannot be considered to be relevant to explain the way in which a shareholder with shares in a non-resident company was taxed in 2001. In such a case, the 'full taxation', as envisaged by the German Government, cannot be achieved in any case since the profits of the non-resident company are taxed in another Member State.

29 That interpretation is not affected by the fact, referred to by the German Government, that the shareholder concerned could sell his shareholding after the company had retained the non-distributed profits for several years. Whether the profits are retained or not, it is impossible, in the case of a shareholder, such as Mr Grønfeldt, to end up with 'full taxation', as envisaged by the German Government.

30 It is thus not apparent from the documents before the Court that the decision in 2001 to adopt the criteria of a shareholding of 1% of the capital of a non-resident company rather than 10% of that same shareholding, for setting the threshold for taxation of profits made by a shareholder, was necessary to ensure that 'full taxation'.

31 It follows from the foregoing that a difference in treatment, such as that at issue in the main proceedings, cannot be regarded as being justified by the need to ensure the coherence of the tax system.

32 As regards, second, the argument that a Member State seeking, in the long term, to bring the national corporate tax system into line with Community law and to

remove any possible discrimination should be granted a certain margin of discretion for the setting-up of a provisional system, it should be pointed out that that margin of discretion must always be limited by the respect of the fundamental freedoms including, in relation to the case in the main proceedings in particular, the free movement of capital.

33 Even if a provisional system, such the one at issue in the main proceedings, may, in respect of the taxation of profits from the sale of shares in resident companies, be understood as a legitimate concern to ensure a smooth transition from the old to the new system, such a factor does not, by itself, justify a difference in treatment such as that at issue in the main proceedings, to the detriment of the taxation of the profits made from sales of shares in non-resident companies.

34 It is thus apparent from the documents before the Court that a difference in treatment, such as that at issue in the main proceedings, does not appear to be justified by an overriding reason of public interest.

35 Consequently, the answer to the question referred must be that Article 56 EC is to be interpreted as precluding the legislation of a Member State, such as that at issue in the main proceedings, by which the profits from a sale of shares in 2001 in a limited company established in another Member State are immediately taxable where the seller had held, either directly or indirectly, a share of at least 1% of the company's capital within the previous five years, whereas the profits from the sale of shares in 2001, in the same circumstances, in a limited company established in that first Member State subject to unlimited corporation tax were subject to tax only in the case of a substantial shareholding of at least 10%.

Costs

36 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Second Chamber) hereby rules:

Article 56 EC is to be interpreted as precluding the legislation of a Member State, such as that at issue in the main proceedings, by which the profits from a sale of shares in 2001 in a limited company established in another Member State are immediately taxable where the seller had held, either directly or indirectly, a share of at least 1% of the company's capital within the previous five years, whereas the profits from the sale of shares in 2001, in the same circumstances, in a limited company established in that first Member State subject to unlimited corporation tax were subject to tax only in the case of a substantial shareholding of at least 10%.

[Signatures]