

OPINION OF ADVOCATE GENERAL

LÉGER

delivered on 1 March 2005¹

1. This case raises once more the issue of how Community law affects the tax situation of those who do not reside in the Member State in which they pay tax.

taxation in Germany of natural persons resident in France are contained principally in the 1987 Income Tax Law ('Einkommensteuergesetz', hereinafter the 'EStG 1987') and in the double-taxation convention between France and Germany (hereinafter 'the Convention').²

2. More specifically, what has to be examined is whether it is contrary to Community law that German nationals who are resident in France and working in a state secondary school in Germany cannot claim rental income losses arising from the use of their house for their own needs in the computation of their income tax in Germany.

A — Assessability to income tax in Germany of natural persons resident in France and working in Germany

I — The relevant provisions of national tax law

3. The relevant provisions concerning the assessability to income tax and the determination of the taxable income and rate of

4. Paragraph 1 of the EStG 1987 specifies which natural persons are assessable to tax in Germany. It provides that all persons, irrespective of nationality, having their permanent residence or usual abode within the

¹ — Original language: French.

² — Convention signed in Paris on 21 July 1959 between the French Republic and the Federal Republic of Germany for the avoidance of double taxation and the establishment of rules for mutual legal and administrative assistance in the field of income and wealth tax and in the field of business tax and land tax. This Convention was subsequently amended by the protocols signed in Bonn on 9 June 1969 and 28 September 1989 and by the protocol signed in Paris on 20 December 2001.

national territory are subject to German tax (Paragraph 1(1)), as are German nationals not having their permanent residence or usual abode in Germany but who work in the public service in Germany or abroad (Paragraph 1(2) and (3)).³

5. In the case of German nationals resident in France, the provisions of the Convention operate to determine which State has jurisdiction to tax their income. Thus, Article 14(I) of the Convention provides that remuneration paid by one of the Contracting States, by a *Land*, or by a public corporation of that State or *Land*, in consideration of administrative or military services, to natural persons who are nationals of that State of employment but residents of the other State, is taxable only in the State that pays it.

6. In accordance with that provision, the income of a German national resident in France and working as a teacher in a state secondary school in Germany is taxable in Germany. By contrast, a natural person having French nationality only and who resides in France while working in a state secondary school in Germany will be assessable to income tax in France and not in Germany.

B — *Determination of the income taxable in Germany of natural persons resident in France and working in Germany*

7. The first sentence of Article 20(I)(a) of the Convention, in combination with Article 2(I)(4)(a) thereof, exempts from taxation in Germany income arising in France and assets located in France, which, according to the Convention, are taxable in France.

8. Under Article 3(I) and (IV) of the Convention, income from immovable property is taxable only in the Contracting State in which the property is situated. This covers all income from the exploitation of immovable property, including, for example, from letting.

9. Under German law, the term ‘income’ covers both *positive income*, which is to be construed as a gain for the individual concerned, and *negative income*, which denotes a loss or *lucrum cessans* for that individual.

³ — The same applies, in certain circumstances, to the family members and spouse of the German national.

10. Such negative income, according to German law, can arise as a result of natural persons using their immovable property for their personal use.⁴

11. The combined effect of the provisions in question is that negative income from immovable property situated abroad cannot be taken into account for the purposes of determining the income taxable in Germany of natural persons resident in France.

12. I should mention that negative income of that kind is also excluded from recognition under German law taken in isolation. The fourth point of the first sentence of Paragraph 2a(1) of the EStG 1987 provides that negative foreign income arising from the letting of immovable property situated in another State may be set off only against foreign income of the same kind arising in the same State.

C — Determination of the rate of taxation in Germany of natural persons resident in France and working in Germany

13. Under the second sentence of Article 20(I)(a) of the Convention, the exclusion of

income arising in France from the calculation of the income liable to tax in Germany does not restrict the right of the Federal Republic of Germany to take account of such income for the purposes of determining the rate of taxation.

14. Accordingly, German tax law provides that foreign income which is exempt under a double-taxation convention is included in the taxpayer's taxable income for the sole purpose of determining the applicable rate of tax.⁵ The effect of this provision is that the taxable income used to determine the rate of taxation is *notional*.

15. This progressivity provision can be described as 'negative',⁶ in the case of negative income that has the effect of reducing the notional taxable income, thereby leading to the application of a lower tax rate.

16. However, according to the case-law of the Bundesfinanzhof (Federal Finance Court) (Germany),⁷ the fourth point of the first

4 — The national court refers, in this regard, to Paragraph 21(2), first sentence, and to Paragraph 52(21), second sentence, of the EStG 1987.

5 — See Paragraph 32b(2)(2) in conjunction with Paragraph 32b(1)(2) of the EStG 1987.

6 — See order for reference, p. 2.

7 — See, in particular, the following decisions of the Bundesfinanzhof: 17 October 1990, I R 182/87, DB 1991, p. 314; I R 177/87, BFH/NV 1992, p. 104; 13 May 1993, IV R 69/92, BFH/NV 1994, p. 100; and 17 November 1999, I R 7/99, BFHE 191, p. 108.

sentence of Paragraph 2a(1) of the EStG 1987 means that that rule does not apply in the case of negative foreign income from lettings of property situated abroad. As a result, negative foreign income cannot be included in the notional taxable income used to determine the rate of taxation.⁸ Moreover, the second sentence of Paragraph 2a(1) of the EStG 1987 expressly excludes Paragraph 10d of the EStG 1987, which provides that negative income may be included in certain circumstances.

were jointly assessed in Germany for the 1987 tax year as natural persons liable to income tax on their total income.

18. The spouses owned a house situated in France but both worked as teachers in a state secondary school in Germany.¹⁰

II — Facts and procedure in the main proceedings

17. Mr Hans-Jürgen and Mrs Monique Ritter-Coulais, both German nationals,⁹

19. According to the order for reference, the Ritter-Coulais claimed that, in accordance with Paragraph 32b(1)(2) and (2)(2) of the EStG 1987, the negative rental income resulting from their occupancy of their house in France for their own habitation needs should be included in the computation used to determine their tax rate.¹¹

8 — The reasoning behind the exclusion of negative foreign income in the computation of the tax rate may be summarised as follows: the starting-point is that the first sentence of Paragraph 2a(1) of the EStG 1987 provides, under point 4, that negative foreign income arising from the letting of property situated in a foreign State can be set off only against foreign income of the same type arising in the same State. The referring court notes that it is this 'prohibition [actually a limitation] on the setting off of losses' which led, 'in the scheme of the statute, to the exclusion of the foreign income referred to in this provision from the computation of income tax under Paragraph 32b(1)(2) and (2)(2) of the EStG 1987'. It adds that 'the same applies where the income in question is exempt under a double-taxation convention' (order for reference, section II(2)(b)). In other words, negative income from a property situated in France can be set off only against positive income from a property situated in France.

9 — At the hearing, counsel for the couple explained that Mr Ritter-Coulais was German while Mrs Ritter-Coulais was a French national who had acquired dual nationality by marriage.

10 — It was therefore as German nationals resident in France and working in a state secondary school in Germany that the couple was charged to income tax in Germany in the 1987 tax year. The fact that Ms Ritter-Coulais also had French nationality was therefore not relevant for the purposes of liability to income tax in Germany.

11 — According to those national provisions, it will be recalled, foreign income that is exempt under a double-taxation convention is included in the computation of notional taxable income for the purpose only of determining the rate of taxation.

20. The tax administration denied that claim on the strength of the fourth point of the first sentence of Paragraph 2a(1) of the EStG 1987, according to which negative foreign income arising from the letting of property situated abroad cannot be taken into account for the purposes of determining the tax rate.¹²

21. The Ritter-Coulais challenged the tax administration's decision in the Finanzgericht (Finance Court) (Germany). The Finanzgericht dismissed the challenge, taking the view, *inter alia*, that the plaintiffs had not been victims of discrimination contrary to Community law since natural persons resident in Germany are likewise unable to deduct such 'foreign' losses.¹³

22. The Ritter-Coulais then appealed that decision of the Finanzgericht to the Bundesfinanzhof on points of law. As well as seeking to have the decision set aside, they claim an adjustment of their tax assessment so as to take account of rental income losses in the computation to determine the applicable rate of taxation for the 1987 tax year.

12 — It may therefore be inferred that, for the purposes of the application of these national provisions, the *rental income losses* claimed by the Ritter-Coulais and which arise as a result of their self-occupancy of their French residence are treated as *negative foreign income from the letting of property situated abroad*.

13 — See order for reference, p. 3.

III — The reference for a preliminary ruling

23. In order to adjudicate on that appeal, the Bundesfinanzhof decided to refer the following questions to the Court for a preliminary ruling:

'(1) Is it contrary to Article 43 and Article 56 of the Treaty establishing the European Community that a natural person assessable to tax in Germany on his or her total income and in receipt of income from an employment there cannot deduct rental income losses arising in another Member State in the computation of taxable income in Germany?

(2) If that question is answered in the negative: is it contrary to Article 43 and Article 56 of the Treaty establishing the European Community that such losses are also not recognisable for the purposes of the negative tax progression clause ("negativer Progressionsvorbehalt")?'

IV — Analysis

A — *The Community law to be interpreted*

24. The two questions referred concern the interpretation of Article 43 EC, on the freedom of establishment of nationals of a Member State in the territory of another Member State, and of Article 56 EC, on the free movement of capital and payments.

25. However, it is clear from the file that the dispute in the proceedings pending before the national court concerns natural persons who, as teachers at a German state secondary school, are working *as employees* in a Member State.

26. That being so, it therefore appears that an interpretation of Article 43 EC would have no bearing on the issue and can be of no assistance in resolving the dispute in the main proceedings. It is expressly clear from the text of the second paragraph of Article 43 EC that '[f]reedom of establishment' comprises 'the right to take up and pursue activities *as self-employed persons* ...'.¹⁴

27. The same conclusion must be reached with regard to the request for an interpretation of Article 56 EC, since the scope *ratione materiae* of that article does not cover the facts at issue in the main proceedings.

28. As the Court has defined them, 'movements of capital are financial operations essentially concerned with the investment of the funds in question',¹⁵ rather than remuneration for a service. Moreover, it is interesting to note that Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty,¹⁶ albeit not applicable at the material time, contains an annex with an illustrative nomenclature of capital movements divided into 13 headings, one of which is investments in real estate.

29. However, there is nothing in the order for reference to indicate that the facts of the case involve a cross-border movement of capital in connection with an investment in real estate.

¹⁴ — Emphasis added.

¹⁵ — Joined Cases 286/82 and 26/83 *Luisi and Carbone* [1984] ECR 377, paragraph 21.

¹⁶ — OJ 1988 L 178, p. 5.

30. That is why the interpretation of Article 56 EC cannot, in my view, be of any use or relevance in the resolution of the dispute in the main proceedings.

31. However, it is settled case-law that the Court has jurisdiction under Article 234 EC to provide a referring court with all the guidance on the interpretation of Community law that may be helpful to it in resolving the dispute in the main proceedings. For that purpose, the Court 'may deem it necessary to consider provisions of Community law to which the national court has not referred in its question'.¹⁷

32. In the light of those considerations, it seems to me that the questions referred by the Bundesfinanzhof have to be construed as seeking an interpretation of the relevant Community law, in this case Article 48 of the EEC Treaty (which became Article 48 of the EC Treaty, which in turn became, after amendment, Article 39 EC), in so far as it concerns workers in the Community law definition of the term. There is settled case-

law that 'a person who, for a certain period of time, performs services for and under the direction of another person in return for which he receives remuneration must be considered to be a worker'.¹⁸

B — *The requirement of a sufficient foreign element for the purposes of Community law*

33. We have just seen that, *ratione materiae*, the fact that the Ritter-Coulais are employees brings them, on the face of it, within the scope of Article 48 of the Treaty.

34. However, it is settled case-law that that article applies only to situations within the scope *ratione personae* of Community law, in other words, situations which involve a sufficient foreign element to trigger its application.¹⁹

17 — Case C-241/89 *SARPP* [1990] ECR I-4695, paragraph 8. See, in particular, to the same effect, Case C-315/92 *Verband Sozialer Wettbewerb ('Clinique')* [1994] ECR I-317, paragraph 7, Case C-87/97 *Consorzio per la tutela del formaggio Gorgonzola* [1999] ECR I-1301, paragraph 16, and Case C-365/02 *Lindfors* [2004] ECR I-17183, paragraph 32.

18 — Case C-85/96 *Martínez Sala* [1998] ECR I-2691, paragraph 32.

19 — More generally, the Treaty provisions on freedom of movement for workers, freedom of establishment and freedom to provide services 'cannot be applied to activities which are confined in all respects within a single Member State' (Case C-134/95 *USSL n° 47 di Biella* [1997] ECR I-195, paragraph 19). See, to the same effect, Case C-41/90 *Höfner and Elser* [1991] ECR I-1979, paragraph 37; Case C-332/90 *Steen* [1992] ECR I-341, paragraph 9, and Joined Cases C-29/94 to C-35/94 *Aubertin and Others* [1995] ECR I-301, paragraph 9.

35. It therefore has to be examined whether the fact that Mrs Ritter-Coulais had dual French and German nationality in 1987 and the fact that the couple were resident in France at that time constitute sufficient foreign elements for the purposes of the Community law then applicable.

36. I can say straight away that the fact that Mrs Ritter-Coulais had dual nationality in 1987 does not seem to me sufficient to ‘communitise’ the situation of the two spouses, who were jointly assessed to tax in Germany as German nationals. As we have seen, only the German nationality of the spouses was taken into account for the purposes of their assessment to income tax in Germany, in which context the couple were treated, if I may say, as a single entity.²⁰ For that reason I do not think there is any point in conducting a separate analysis of each spouse’s situation in terms of Community law, which would ultimately be an artificial exercise in the light of the fact that they were jointly assessed.

37. Nor, furthermore, does the situation of Mr and Mrs Ritter-Coulais seem to me comparable to that of Mrs Gilly, considered by the Court in Case C-336/96.²¹ Mrs Gilly was a German national who had acquired French nationality by marriage and who taught at a state school in Germany. Mr

and Mrs Gilly resided in France. Mrs Gilly’s income from her employment was taxed in Germany, in accordance with the first sentence of Article 14(I) of the Convention, on the basis that it was public-service remuneration paid to a German national.²² Mrs Gilly’s income was also taxed in France, where it entitled her to a tax credit equal to the amount of the French tax on that income²³ but less than the tax paid in Germany, which was what led to the proceedings brought by Mr and Mrs Gilly against the French administration.

38. In that case, the French Government argued that Mrs Gilly had not exercised her rights under Article 48 of the Treaty in France since she was working in her State of origin, Germany.

39. In response to that argument, and holding that Mrs Gilly’s situation did in fact come within the rules on freedom of movement for workers, the Court stated that ‘[i]t need merely be pointed out ... that Mrs Gilly has acquired French nationality by her marriage and works in Germany whilst residing in France. She must therefore be

20 — See points 17 and 18 of this Opinion and particularly footnote 9.

21 — [1998] ECR I-2793.

22 — See points 5 and 6 of this Opinion.

23 — Under Article 20(II)(a)(cc) of the Convention, as amended by the protocol signed on 28 September 1989.

considered *in France* as a worker exercising her right to freedom of movement, as guaranteed by the Treaty, in order to work in a Member State other than that in which she resides. The circumstance that she has retained the nationality of the State in which she is employed in no way affects the fact that, *for the French authorities*, she is a French national working in another Member State'.²⁴

40. In short, from the point of view of the French authorities and in relation to the taxation in France of income from an employment in Germany, Mrs Gilly had indeed to be regarded as moving outside France in order to engage in gainful, and hence economic, activity in another Member State.

41. The situation of the Ritter-Coulais, however, has to be analysed from a different point of view, that of the German authorities, in relation to the taxation in Germany of income from employment in Germany. It is then clear that, for the German authorities, the couple earn their livelihood in Germany and move only to return to their residence in France.

42. Those points having been noted, I would add that, to my mind, residence in another Member State did not, at the time material to the main proceedings, namely 1987, constitute a foreign element sufficient to bring a situation such as that of the Ritter-Coulais within the scope *ratione personae* of the Community law then applicable.

43. This conclusion follows, it seems to me, from the fact that the Community law applicable in 1987 contemplated freedom of movement for persons only from an economic perspective.

44. It may be recalled here that the Court has stated as a general proposition that '[a]ny Community national who, irrespective of his place of residence and his nationality, *has exercised the right to freedom of movement for workers* and who *has been employed in another Member State*, falls within the scope of the [the Treaty] provisions [on freedom of movement for workers]'.²⁵

24 — *Gilly*, paragraph 21 (emphasis added).

25 — Case C-419/92 *Scholz* [1994] ECR I-505, paragraph 9 (emphasis added).

45. Apart from being employed in another Member State, other circumstances constituting a sufficient foreign element to warrant the application of Community law are the acquisition of a diploma or a vocational qualification in another Member State.²⁶

enjoying the rights and liberties guaranteed by the treaty'.²⁷

46. The presence of such a foreign element, besides connecting the situation in question to Community law, means that in certain cases it is accordingly possible to counter what is often termed 'reverse discrimination', meaning treatment by a Member State which places its own nationals at a disadvantage compared with nationals of other Member States.

48. However, instances of reverse discrimination can be sanctioned under Community law only if the situation in question is itself 'communitised'. Otherwise, the consequences of reverse discrimination will depend on the applicable national law.

47. Thus, when nationals of a Member State have by their conduct placed themselves in *one of the situations governed by Community law*, such as the acquisition of a vocational qualification in another Member State, they may rely on the Treaty rules on freedom of movement for persons as against their State of origin. In those circumstances, the persons in question are then 'with regard to their State of origin, in a situation which may be assimilated to that of any other persons

49. In the light of those considerations, I note that there is nothing in the file to suggest that Mr and Mrs Ritter-Coulais set up home in France 'in order to pursue an economic activity there'²⁸ or to acquire a vocational qualification there. It seems on the contrary that they chose to settle in France for reasons of a purely personal nature. They pursued their occupation as employees in the State of which they were nationals, namely Germany, and the only element external to that State was therefore the place of their residence, namely France.

26 — See, in particular, Case 115/78 *Knoors* [1979] ECR 399, the case in which the rule was first laid down, in relation to freedom of establishment. The same reasoning must be followed in relation to freedom of movement for workers: see Case C-19/92 *Kraus* [1993] ECR I-1663, paragraphs 15 and 16.

27 — *Knoors*, paragraph 24.

28 — Case C-370/90 *Singh* [1992] ECR I-4265, paragraph 17.

50. In other words, Mr and Mrs Ritter-Coulais did not avail themselves of the freedom of movement enshrined in Article 48 of the Treaty in order to work in a Member State other than that of which they were nationals.

51. In this regard, I note a similarity with *Werner*,²⁹ where the facts were fully comparable to the situation of Mr and Mrs Ritter-Coulais in 1987.

52. In that case, Mr Werner, a dentist of German nationality who had a dental practice in Germany and who had obtained his degrees and qualifications in Germany, was resident in the Netherlands. He wanted his personal situation to be taken into account in the taxation of his German income in order to gain the benefit of a preferential scale, known as the 'splitting tariff', available to married couples. His claim was rejected by the competent national authority on the basis that he was not resident in Germany and could not therefore be treated as taxable on his total income, which was a condition for the preferential treatment in question.

53. In the light of those facts, questions were referred to the Court on the interpretation of Article 52 of the EEC Treaty (which became Article 52 of the EC Treaty, which in turn, after amendment, became Article 43 EC).

54. In its judgment, the Court noted that, as well as being a German national who had obtained his degrees and qualifications in Germany, Mr Werner had 'always practised his profession in Germany and [was] subject to German tax legislation'. The Court further noted that '[t]he only factor which takes his case out of a purely national context is the fact that he lives in a Member State other than that in which he practises his profession'.³⁰

55. It therefore held that 'Article 52 of the EEC Treaty does not preclude a Member State from imposing on its nationals who carry on their professional activities within its territory and who earn all or almost all of their income there or possess all or almost all of their assets there a heavier tax burden if they do not reside in that State than if they do'.³¹

29 — Case C-112/91 *Werner* [1993] ECR I-429.

30 — *Werner*, paragraph 16.

31 — *Werner*, paragraph 17.

56. In his Opinion in *Werner*,³² Advocate General Darmon proposed that the Court should rule that '[n]either Article 52 nor Article 7 applies to a situation which is purely internal to a Member State ...'.³³

57. In any event, albeit without expressly characterising the situation in question as a 'situation which is purely internal to a Member State', which in my opinion would have been the logical conclusion from the grounds of the judgment, the Court concurred in the result with the Advocate General's view inasmuch as it held that residence in another Member State did not on its own constitute a sufficient foreign element to engage the Treaty rules on freedom of establishment.³⁴

58. I also believe that there is no reason why this view should not be transposed into the area of freedom of movement for workers, which is similarly concerned with the right of Member State nationals to move between Member States in order to carry on an economic activity.

59. What is more, I believe that the rationale underlying *Werner* must be maintained, in spite of the criticism it has attracted.³⁵

60. There is no basis, in my view, for departing from the view of the law expressed by Advocate General Darmon in his Opinion in *Werner*: 'Until the adoption on 28 June 1990 of the Council directives relating to the right of residence, which make that right more widely available, the free movement of persons within the Community was determined — and delimited — by the economic character of the Treaty. It follows that the freedom of movement granted to Community nationals is deemed to involve move-

32 — Opinion delivered on 6 October 1992.

33 — *Ibid.*, point 55.

34 — I agree with the analysis of Advocate General Tizzano, who takes the view that 'in *Werner*, the Court did no more than to uphold the principle according to which Community law does not apply to situations in which the key elements are purely internal to a Member State'. See point 83 of the Opinion in *Schilling and Fleck-Schilling* (Case C-209/01 [2003] ECR I-13389).

35 — The implications of *Werner* have been described as 'disconcerting' (note by X. Rohmer, Commentary 1000, *Droit fiscal* 1993, n° 19). According to another, more moderate, view, the rule 'has probably been overtaken by the entry into force of the Treaty of European Union and the establishment of Citizenship of the Union' (P. Derouin and P. Martin, *Droit communautaire et fiscalité — Sélection d'arrêts et de décisions*, Litec, 2004, p. 48). Leaving aside that debate, I note that the French Conseil d'État, in a decision of 8 July 2002, followed the interpretation adopted by the Court in *Werner* in a case concerning income tax in respect of the years 1987 and 1988 (requête n° 225159, Inédit au Recueil Lebon).

Finally, I do not agree with the view that the Court overruled *Werner* in *Schumacker* (Case C-279/93 [1995] ECR I-225). As I stated in my Opinion in *Schumacker* (point 33), it was clear that Mr Schumacker's situation, unlike that of Mr Werner, did indeed fall within the scope of Community law. Mr Schumacker, a Belgian national who had acquired his qualifications and professional experience elsewhere than in the Federal Republic of Germany, exercised the right of freedom of movement for workers laid down in Article 48 of the Treaty in order to go to Germany and take up employment there. The situation was therefore not purely internal to a Member State.

ment for the purposes of an economic activity'.³⁶

61. In 1987, at the time material to the main proceedings, neither the 1990 directives on the right of residence nor Article 8A of the EC Treaty inserted by the Treaty of Maasticht (now, after amendment, Article 18 EC) were in force. Being inapplicable *ratione temporis* to the facts of the dispute before the national court, as was also the case in *Werner*, the provisions in question will not be taken into account in my analysis.

62. I accordingly share the Commission's view³⁷ that principles derived from Article 18 EC cannot be applied to situations which began and ended before that provision entered into force.

63. To proceed otherwise, in other words, to take into consideration the rules and principles governing European citizenship and to analyse them in relation to a dispute dating from 1987 would, in my view, be contrary to the requirement of legal certainty.

64. According to the principle of legal certainty, which is a fundamental principle of Community law, 'Community legislation must be unequivocal and its application must be predictable for those who are subject to it'.³⁸ Those requirements of certainty and predictability necessarily entail, in my view, that a situation obtaining on a given date must be examined solely in the light of the rules of law in force as at that date.³⁹

65. Those points having been noted, I do however wish to state, in line with what I wrote in my Opinion in *Asscher*,⁴⁰ that the

38 — Case 70/83 *Kloppenborg* [1984] ECR 1075, paragraph 11. See also Case C-354/95 *National Farmers' Union and Others* [1997] ECR I-4559, paragraph 57.

39 — That does not mean, however, that account cannot be taken of subsequent decisions of the Court of Justice concerning the interpretation of the rules applicable at the time of the facts at issue in the main proceedings. It is settled case-law that in the preliminary ruling procedure the Court determines the meaning and scope of the relevant rule of Community law 'as it must be or ought to have been understood and applied from the time of its coming into force' (see Case 61/79 *Denkavit Italiana* [1980] ECR 1205, paragraph 16).

40 — Case C-107/94 [1996] ECR I-3089. See, in particular, point 41 of my Opinion in that case: 'I think it likely that the Court will in future have to rule on discrimination suffered by nationals of a Member State who have exercised their freedom of movement only under, say, Directive 90/364, which now recognises a general right of residence subject to certain conditions, regardless of any economic activity'. It is interesting to note, besides, for the sake of distinguishing clearly the different situations that have come before the Court, that Mr Asscher, unlike Mr Werner, was entitled to rely on Article 52 of the Treaty as against his State of origin since 'by virtue of pursuing an economic activity in a Member State other than his State of origin, he is, with regard to the latter, in a situation which may be regarded as equivalent to that of any other person relying as against the host Member State on the rights and liberties guaranteed by the Treaty' (*Asscher*, paragraph 34).

36 — See point 30.

37 — See paragraph 52 of its written observations.

secondary Community law on the right of residence⁴¹ as well as Article 18 EC do, in my opinion, mean that residence in another Member State constitutes in itself a sufficient foreign element to bring the situation of Community nationals within the scope of Community law.

66. The Court, moreover, has held that while citizenship of the Union is not intended to extend the scope *ratione materiae* of the Treaty to internal situations which have no link with Community law, such a link with Community law does, however, exist ‘in regard to persons ... who are nationals of one Member State lawfully resident in the territory of another Member State’.⁴²

67. That reasoning, based on the legal effects of the concept of ‘European Citizenship’, must be put to one side, however, in the context of this analysis, since the foreign element consisting solely of residence in another Member State was not sufficient, under the Community law applicable in

1987, to entitle individuals in a situation such as that of Mr and Mrs Ritter-Coulais to the protection of the Treaty rules on freedom of movement for workers.

68. Does this conclusion automatically mean that no answer should be proposed on the substance of the questions referred to the Court? That is what now has to be considered.

C — Whether it is necessary to provide the national court with an answer in regard to the interpretation of the relevant Community law

69. In the past, the Court has seen fit not to express a view on the merits of questions referred to it for a preliminary ruling on the basis that Community law did not apply to purely internal disputes, in other words, for example, those having ‘no connection whatsoever with any of the situations envisaged by Community law in the area of freedom of movement for persons and services’.⁴³

41 — Consisting principally of Council Directive 90/364/EEC of 28 June 1990 on the right of residence (OJ 1990 L 180, p. 26). That directive was repealed by Directive 2004/38/EC of the European Parliament and of the Council of 29 April 2004 on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States (OJ 2004 L 158, p. 77).

42 — Case C-148/02 *García Avello* [2003] ECR I-11613, paragraphs 26 and 27.

43 — *UISSL n° 47 di Biella*, cited above (paragraph 22).

70. The Court has modified its case-law on this point, however. Thus, under a precedent developed in relation to the free movement of goods,⁴⁴ then extended to the area of free movement of capital,⁴⁵ the fact that the relevant features of the dispute in the main proceedings are confined to a single Member State does not, of itself, make the question referred by the national court inadmissible.

71. The Court takes the view that '[i]n principle, it is for the national courts alone to determine, having regard to the particular features of each case, both the need for a preliminary ruling in order to enable them to give their judgment and the relevance of the questions which they refer to the Court'.⁴⁶ And the Court has added that '[a] reference for a preliminary ruling from a national court may be rejected by the Court only if it is quite obvious that the interpretation of Community law sought by that court bears no relation to the actual nature of the case or the subject-matter of the main action'.⁴⁷

72. The latter situation, where the Court refrains from giving a ruling, is regarded by the Court as 'the exceptional case'.⁴⁸

73. In the light of those principles, and once 'it is not obvious that the interpretation of Community law requested is not necessary for the national court',⁴⁹ the Court holds that it must reply to the questions referred by the national court.

74. The Court considers, more specifically, that '[s]uch a reply might be useful to it if its national law were to require that [a national of the Member State in question] must be allowed to enjoy the same rights as those which a national of another Member State would derive from Community law in the same situation'.⁵⁰

75. I am aware that the approach whereby the Court asserts jurisdiction to reply to questions concerning provisions of Community law in circumstances where the facts at

44 — Case C-448/98 *Guimont* [2000] ECR I-10663.

45 — Joined Cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Reisch and Others* [2002] ECR I-2157 and Case C-300/01 *Salzmann* [2003] ECR I-4899.

46 — See, in particular, *Guimont* (paragraph 22).

47 — Case C-281/98 *Angonese* [2000] ECR I-4139, paragraph 18. Note that that was a case concerning freedom of movement for workers, which may lend weight to the view that the rule laid down subsequently in *Guimont* can also affect that area.

48 — *Salzmann*, paragraph 32.

49 — *Guimont*, paragraph 23.

50 — *Reisch*, paragraph 26. The explanation for this position seems to be, in the words of Advocate General Geelhoed in his Opinion in that case, that if 'national law prohibits reverse discrimination, a national court will, after all, need an interpretation of the claims that nationals of other Member States are entitled to assert under Community law if it is to be able to determine whether the case before it involves reverse discrimination' (point 87).

issue in the main proceedings lie outside the scope of Community law has been the subject of discussion.⁵¹

with its own case-law, from expressing a view on the Community law to be interpreted, I will therefore now proceed to consider the merits of the two questions referred by the national court, which in my view call for a single analysis.

76. Nevertheless, whatever the merits of the arguments raised against the approach fashioned by the Court in its case-law, I cannot ignore that approach here. Accordingly, I will propose that the Court should consider the substance of the questions referred by the Bundesfinanzhof.

77. Having established, in turn, that the dispute in the main proceedings falls within the scope *ratione materiae* of the rules on free movement for workers and not of those on freedom of establishment and free movement of capital, that the situation *ratione personae* of the plaintiffs in 1987 did not involve any foreign element relevant for the purposes of Article 48 of the Treaty, and, finally, that the latter fact does not automatically prevent the Court, in accordance

78. Thus, by its two questions, which fall to be examined together, the national court asks, in substance, whether Article 48 of the Treaty must be interpreted as meaning that it is contrary to that article that nationals of a Member State, who are assessable to tax in Germany on their total income⁵² and who are in receipt of income from an employment in Germany, cannot claim rental income losses incurred in another Member State through their use of their house for their own needs, either for the purposes of determining their taxable income in Germany or in the computation which determines their rate of income tax in that Member State.

51 — See, in particular, the Opinion of Advocate General Jacobs in *Pistre and Others* (Joined Cases C-321/94 to 324/94 [1997] ECR I-2343, point 38 et seq.) and those of Advocate General Saggio in *Guimont*, points 6 and 7. The discussion also concerns the scope of the rule in *Dzodzi* (Joined Cases C-297/88 and C-197/89 [1990] ECR I-3763), which relates more specifically to the case where a provision of national law contains a reference to Community law: see the Opinions of Advocate General Jacobs in *Leur-Bloem* and *Giloy* (Cases C-28/95 [1997] ECR I-4161, point 47 et seq., and C-130/95 [1997] ECR I-4291), and in *BIAO* (Case C-306/99 [2003] ECR I-1, points 47 to 70).

52 — I am here employing the actual expression used by the national court in its first question. Although this is not made explicit in the order for reference, it seems that the expression '*unbeschränkt steuerpflichtige*' is to be understood as signifying that Mr and Mrs Ritter-Coulais were treated in Germany as persons liable to tax on the whole of their income, a treatment normally reserved for German residents (see, in particular, the judgments in *Werner and Schumacker*, cited above). This appears to constitute an exception which concerns civil servants not resident in Germany.

D — *Whether there is indirect discrimination contrary to the Treaty rules on freedom of movement for workers*

mainly to the detriment of nationals of other Member States, since non-residents are in the majority of cases foreigners, and thus to constitute indirect discrimination by reason of nationality.⁵⁶

79. It is settled case-law that, while direct taxation does not as such fall within the competence of the Community, powers retained by the Member States in that domain must none the less be exercised consistently with Community law.⁵³ Freedom of movement for workers entails the abolition of any discrimination based on nationality between workers of the Member States, inter alia as regards remuneration. In its judgment in *Biehl*,⁵⁴ the Court held that the principle of equal treatment with regard to remuneration would be rendered ineffective if it could be undermined by discriminatory national provisions on income tax.

80. It is also settled that the rules regarding equality of treatment forbid not only overt discrimination by reason of nationality but also all covert forms of discrimination which, by applying other distinguishing criteria, in fact achieve the same result.⁵⁵ The Court has held that a national rule which restricts tax benefits to residents only is liable to operate

81. None the less, ‘... discrimination can arise only through the application of different rules to comparable situations or the application of the same rule to different situations’.⁵⁷

82. The Court has recently reiterated that ‘in relation to direct taxes, the situations of residents and of non-residents are generally not comparable, because the income received in the territory of a State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence, and because a non-resident’s personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is easier to assess at the place where his personal and financial interests are centred, which in general is the place where he has his usual abode’.⁵⁸

53 — See, in particular, Case C-246/89 *Commission v United Kingdom* [1991] ECR I-4585, paragraph 12, and *Schilling*, cited above, paragraph 22.

54 — Case C-175/88 [1990] ECR I-1779, paragraph 12.

55 — See, in particular, Case 152/73 *Sotgiu* [1974] ECR 153, paragraph 11, and Case C-27/91 *Le Manoir* [1991] ECR I-5531, paragraph 10.

56 — See, in particular, *Schumacker*, paragraph 28, *Asscher*, paragraph 38, and Case C-87/99 *Zurstrassen* [2000] ECR I-3337, paragraphs 19 and 20.

57 — *Schumacker*, paragraph 30.

58 — See, in particular, Case C-169/03 *Wallentin* [2004] ECR I-6443, paragraph 15, and the cases cited there.

83. It follows that ‘the fact that a Member State does not grant to a non-resident certain tax benefits which it grants to a resident is not, as a rule, discriminatory having regard to the objective differences between the situations of residents and of non-residents, 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’.⁵⁹

84. In *Schumacker*, however, the Court held that a non-resident and a resident are not in an objectively different situation where the non-resident receives no significant income in the State of his residence but derives the major part of his taxable income from the State of employment. In such circumstances, the State of his residence is not in a position to grant him the benefits resulting from his personal and family circumstances being taken into account. The difference in treatment then becomes discriminatory against the non-resident because his personal and family circumstances are taken into account neither in the State of residence nor in the State of employment.⁶⁰

85. In relation to the factual and legal context of the dispute in the main proceedings, as described in the order for reference, the principles outlined above lead me to the following analysis.

86. The fourth point of the first sentence of Paragraph 2a(1) of the EStG 1987, which provides, as will be recalled, that negative foreign income arising from the letting of a property situated in a foreign State can be set off only against foreign income of the same kind and arising in the same State, has the effect, in German law, of excluding such income, taken in isolation,⁶¹ not only for the purposes of determining taxable income but also in the computation of the applicable rate of income tax in Germany.⁶²

87. In short, a person subject to tax on his or her total income in Germany, who is owner-occupier of a house in another Member State and who has no rental income in that State, cannot claim losses arising from the owner-occupancy of the property in the computation of his or her tax liability.

88. By contrast, the file shows that if the same person is owner-occupier of a house in Germany he or she can claim such negative

⁵⁹ — Ibid., paragraph 16, and the cases cited there.

⁶⁰ — *Schumacker*, paragraphs 36 to 38.

⁶¹ — In other words, where there is no foreign income of the same kind and from the same State.

⁶² — Reference is made to the explanations provided by the national court, set out in point 16 and in footnote 8 of this Opinion.

income for the purposes of the computation of his or her income tax.⁶³

89. The German tax legislation therefore does indeed have the effect of excluding non-residents from the benefit of a tax advantage, which constitutes a difference in treatment detrimental to non-residents.⁶⁴

90. However, such difference in treatment does not constitute discrimination contrary to the Treaty if the situations of residents and non-residents are, as a rule, objectively different.

91. Non-residents such as Mr and Mrs Ritter-Coulais, all or almost all of whose worldwide income arises in Germany, must be considered, in terms of the rules governing the computation of their income tax, as being in a comparable situation to that of persons who reside and work in that Member State.

63 — See order for reference, paragraphs 2 and 7, and the Commission's written observations, paragraph 33.

64 — Note that, while the tax regime applicable in the dispute in the main proceedings results, as we have seen, from the combined effect of the rules laid down in the Convention and the domestic legislation, it is the latter alone, and more specifically the fourth point of the first sentence of Paragraph 2a(1) of the EStG 1987, which is the direct cause of the difference in treatment between German residents and non-residents.

92. The difference in treatment between taxpayers who work in a Member State but are not resident there and taxpayers who both work and reside in the State in question, which consists in the former being denied recognition of negative letting income, does therefore constitute, to that extent, indirect discrimination based on the criterion of residence, contrary to Article 48 of the Treaty.

93. The reasons on which this view is based have been articulated by the Court in cases concerning the availability to non-resident taxpayers of tax benefits based on personal and family circumstances.

94. In that regard, the case-law of the Court holds that, where a taxable person has exercised the right to freedom of movement, while it is indeed up to the State of residence to take into account that person's personal and family circumstances, the person in question still has to be sufficiently taxable in that State to enable those circumstances to be taken into account. If that is the case then the State of residence will be in a position to take into account the personal and family circumstances of the resident taxpayer.⁶⁵

65 — See, in particular, Case C-391/97 *Gschwind* [1999] ECR I-5451, paragraphs 29 and 30.

95. In that scenario, the tax benefits attaching to taxpayers' personal and family circumstances under the domestic law of the State of employment, which are taken into account in the calculation of income tax, can be denied to non-residents since comparable benefits can be granted to them in their State of residence.

96. On the other hand, if the taxpayer does not have sufficient taxable income in the State of residence for this to be done, it will necessarily be up to the State of employment to do so.⁶⁶

97. The import of this case-law is that the taxation of taxable persons in their State of employment or in their State of residence must not ultimately lead to a situation in which their personal and family circumstances are not taken into account in either, or are taken into account only in part.⁶⁷

98. More generally, this case-law means, in my view, that *non-residents' ability to pay tax*, which depends not only on account being taken of their personal and family circumstances,⁶⁸ but also on *account being taken of their total income and losses*,⁶⁹ should not be assessed differently by the competent authorities on the sole ground of place of residence, where resident and non-resident taxpayers alike receive all or virtually all their taxable income in the taxing State.

99. But that is indeed the situation that results from national legislation which, in the case of non-residents, *takes no account of negative foreign income*, in the form of rental income *losses*, for the purposes of determining taxable income and/or the rate of tax, whereas account is taken of such losses in the case of residents who also receive all or almost all their income in that Member State.

⁶⁶ — See, in particular, Case C-80/94 *Wielockx* [1995] ECR I-2493.

⁶⁷ — See Case C-385/00 *De Groot* [2002] ECR I-11819, where the Court held that 'the mechanisms used to eliminate double taxation or the national tax systems which have the effect of eliminating or alleviating double taxation must permit the taxpayers in the States concerned to be certain that, as the end result, all their personal and family circumstances will be duly taken into account, irrespective of how those Member States have allocated that obligation amongst themselves, in order not to give rise to inequality of treatment which is incompatible with the Treaty provisions on the freedom of movement for workers and in no way results from the disparities between the national tax laws' (paragraph 101).

⁶⁸ — Examples of tax benefits arising from account being taken of taxpayers' personal and family situation include, in my opinion: the mitigation of the progressive nature of income tax rates for married couples (*Schumacker*), the deductibility of profits invested in the formation of a pension reserve (*Wielockx*), or tax allowances related to personal liabilities such as maintenance payments (*De Groot*).

⁶⁹ — This category includes, in my view, Case C-234/01 *Gerritse* [2003] ECR I-5933, at least in the part of the judgment concerned with the deductibility of business expenses. The Court held there that the Treaty rules on freedom to provide services preclude a national provision which, as a general rule, taxes non-residents on their gross income, without deduction of business expenses, whereas residents are taxed on their net income, after deduction of such expenses.

100. On that basis, I take the view that Article 48 of the Treaty must be interpreted as precluding national legislation which has a discriminatory effect of this kind vis-à-vis non-resident workers.

E — *Whether the indirect discrimination may be justified*

101. I am aware that the approach I have adopted, founded on the existing case-law, has the effect of placing resident and non-resident taxpayers on a fully equal footing with regard to a range of tax benefits⁷⁰ which are often inextricably bound up with economic or social policy choices that are the purview of Member States.

103. According to the German Government, the reason why the rental losses in question cannot be deducted is because of the need to maintain the cohesion of the tax regime resulting from the Convention and from domestic law.

102. However, it must be emphasised that such an approach is valid only if all or almost all of the non-resident taxpayer's income arises in the taxing State. Only if that is so will a difference in treatment between residents and non-residents be transformed into discrimination contrary to the Treaty rules on freedom of movement for persons.

104. That cohesion lies in the fact that, since the Federal Republic of Germany has no power to tax income arising from immovable property situated in France, under Article 3(1) of the Convention, it is entitled to refuse to take into account losses associated with such property where they cannot be set off against income of the same kind originating in France.

⁷⁰ — In relation to the range of tax benefits liable to be concerned by such an approach, I note a recent reference for a preliminary ruling by the Bundesfinanzhof on the question as to whether 'a situation whereby a national of another Member State with restricted tax liability in Germany, unlike a person with unrestricted tax liability, may not deduct from his total income as special expenditure the costs incurred by him in obtaining tax advice is contrary to Article 52 of the Treaty establishing the European Community' (emphasis added): order for reference received at the Court Registry on 12 August 2004 in Case C-346/04 *Conijn*, still pending.

105. Furthermore, that tax system was based on rules allocating tax jurisdiction which the Court had accepted could justify differences in tax treatment. The German Government here relies on *Gilly*.

106. I do not find the German Government's argument convincing, first and foremost because it confuses two separate matters, namely the issue of fiscal connecting factors and the issue of justification by the need to maintain the cohesion of the relevant tax regime.

107. In relation to fiscal connecting factors, firstly, the Court went no further, in *Gilly*, than to state that Article 48 of the EC Treaty does not preclude the application of the provisions of a bilateral convention that specify fiscal connecting factors by which workers are assigned to the tax jurisdiction of one or the other State, depending, in particular, on whether they work in the public or private sector and, where they work in the public sector, on whether or not they are nationals of the State in whose public sector they are employed.

108. Such rules do no more than to establish in which Member State a natural person will be subject to income tax.⁷¹ Any resulting differences in terms of the level of taxation applicable in one or other Member State are

due to the absence of harmonisation of direct tax bands at European level.

109. By contrast, what is at issue in the present case are rules to determine taxable income and rate of taxation. In no way does the case call into question the arrangements ordained by the Convention and the EStG 1987, the effect of which is to make natural persons such as Mr and Mrs Ritter-Coulais assessable to income tax in Germany on the basis that they are German nationals working as teachers in a state secondary school in Germany.

110. Nor does this case directly concern the rule for allocating tax jurisdiction, by which, as provided in Article 3(1) of the Convention, 'income from immovable property ... is taxable only in the Contracting State in which the property is situated'.

111. We have already seen that the fact that *losses* from property are not taken into account in Germany is a result not of that article but of domestic law alone.

⁷¹ — That flows from 'the contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation' (*Gilly*, paragraph 30).

112. In relation, secondly, to the argument based on the need to safeguard the cohesion of the relevant tax regime, the Court has very regularly rejected that argument, pointing out that in the cases where it has held that rules liable to restrict fundamental freedoms could be justified by that need⁷² there was a direct link between the deductibility of contributions paid for old-age and life assurance contracts and the taxation of the sums paid out under those contracts.⁷³

the taxation of income from immovable property in the Member State where the property is situated.

113. In order for the justification based on the need to safeguard the cohesion of the relevant tax regime to succeed, there therefore has to be a direct link between the granting of a tax benefit and the offsetting of that benefit by a tax charge, and the deduction and the charge have to arise in relation to the same tax and the same taxpayer.

115. It therefore seems to me that a distinction between residents and non-residents such as that created by the German legislation cannot be justified by the need to safeguard the cohesion of the tax regime in question.

116. Moreover, there is nothing to show that the rental income losses at issue in this case could be recognised in the State of residence in subsequent assessment periods.

114. I take the view that in this case there is no such link between the deduction of rental losses for the purposes of calculating income tax in the Member State of employment, and

117. Finally, I would agree with the referring court that a reduction in tax revenue cannot be regarded as an overriding reason relating to the public interest capable of being relied on in order to justify a national measure which is contrary to a fundamental freedom.⁷⁴

⁷² — Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 28, and Case C-300/90 *Commission v Belgium* [1992] ECR I-305, paragraph 21.

⁷³ — See, in particular, *De Groot*, paragraph 108.

⁷⁴ — See, in particular, Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 59.

V — Conclusion

118. In the light of all these considerations, I propose that the Court should answer the questions referred by the Bundesfinanzhof as follows:

‘Article 48 of the EEC Treaty (which became Article 48 of the EC Treaty, which in turn became, after amendment, Article 39 EC) must be interpreted as meaning that it is contrary to that article that nationals of a Member State, who are assessable to tax in Germany on their total income and who are in receipt of income from employment in Germany, cannot claim rental income losses incurred in another Member State, through their use of their house for their own needs, either for the purposes of determining their taxable income in Germany or in the computation which determines their rate of income tax in that Member State’.