Reports of Cases

OPINION OF ADVOCATE GENERAL
BOBEK
delivered on 14 December 2017 [1]

Case C‑382/16

Hornbach-Baumarkt AG
v
Finanzamt Landau

(Request for a preliminary ruling from the Finanzgericht Rheinland-Pfalz (Germany))

(Reference for a preliminary ruling — Freedom of establishment — Direct taxation — Application of transfer pricing in relation to transactions between resident and non-resident companies)

I. Introduction

1. Hornbach-Baumarkt AG ('Hornbach') provided comfort letters to banks and creditors guaranteeing that the liabilities of some of its foreign subsidiaries would be met. It did not receive any remuneration from the subsidiaries for the comfort letters. Following a tax assessment, the Finanzamt Landau (Tax Office, Landau, Germany; 'the Tax Office') held that the comfort letters had not been granted on arm's-length terms. The Tax Office therefore increased Hornbach's business tax. That was to reflect the notional remuneration that it considered would normally have been paid to Hornbach by an unconnected third party in consideration for the comfort letters.

2. Hornbach brought an action challenging the Tax Office's assessment before the referring court. It argues that the German legislation providing for the adjustment of taxation of transactions between related companies to reflect arm's-length terms violates the EU Treaty provisions on freedom of establishment. In particular, the rule only foresees the adjustment of taxation where foreign related companies are involved. Moreover, the rule does not allow taxpayers to invoke justifications for transactions not carried out on arm's-length terms.

3. In that context, the Finanzgericht Rheinland-Pfalz (Finance Court of the Land of Rhineland-Palatinate, Germany), asks whether the relevant rule under German law is compatible with the EU Treaty provisions on freedom of establishment.

II. Legal framework

4. According to the referring court, if a taxpayer's income from business relations with a related party is reduced as a result of the fact that, in connection with such business relations abroad, it agrees to terms that depart from those that would have been agreed on by unrelated third parties under the same or similar circumstances, then Paragraph 1(1) of the Außensteuergesetz (Foreign Transaction Tax

1 Original language: English.

Law), as amended by the Gesetz zum Abbau von Steuervergünstigungen und Ausnahmeregelungen (Law on the Reduction of Tax Advantages and Exemptions) of 16 May 2003 (BGBl. I, 2003, p. 660; 'the AStG') applies. That provision requires that income be declared as if it had been earned under terms agreed upon between unrelated third parties.

5. A party is related to a taxpayer, inter alia, if the taxpayer has a direct or indirect shareholding in that party of at least 25%.

III. Facts, procedure and questions referred

6. Hornbach ('the Applicant') is a public limited company established in Germany. Its commercial purpose is the operation of do-it-yourself stores in Germany and other countries.

7. In the year at issue (2003), the Applicant had shareholdings in several companies in other countries inside and outside the European Union for which it provided guarantees and comfort letters to creditors and banks without seeking remuneration for doing so. Through, inter alia, its subsidiary Hornbach International GmbH and in turn through the latter's subsidiary Hornbach Holding BV, the Applicant indirectly owned 100% of Hornbach Real Estate Groningen BV and of Hornbach Real Estate Wateringen BV ('the foreign group companies'), both of which were established in the Netherlands.

8. On 25 September 2002, the Applicant gratuitously provided comfort letters in favour of the foreign group companies to the bank providing financing to those companies. It did so because the foreign group companies had negative equity capital and required bank loans of EUR 10 057 000 (Hornbach Real Estate Groningen BV) and EUR 14 800 000 (Hornbach Real Estate Wateringen BV) in order to continue their business operations, and for the planned construction of a store and garden centre. The financing bank had made the granting of the loans contingent on the provision of comfort letters by the Applicant.

9. In the comfort letters dated 25 September 2002, the Applicant undertook vis-à-vis the financing bank to refrain from disposing of or changing its shareholding in Hornbach Holding BV. In addition it undertook to ensure that Hornbach Holding BV would likewise refrain from disposing of or changing its shareholding in the foreign group companies without giving the bank written notice thereof at least three weeks prior to such disposal or change. Furthermore, the Applicant irrevocably and unconditionally undertook to fund the foreign group companies in such a way as to enable them to meet all of their liabilities. The Applicant was thus required to provide the foreign group companies, as necessary, with the requisite funds to enable them to satisfy their liabilities towards the bank. In addition, the Applicant was required to ensure that such funds would be used to settle any liabilities towards the bank.

10. When the Tax Office ('the Defendant') proceeded to a tax assessment of the Applicant, it considered that the terms agreed on between the Applicant and the foreign group companies departed from those that would have been agreed on by unrelated third parties under the same or similar circumstances. Unrelated business partners would agree on remuneration for the provider of a comfort letter due to the associated liability risk. Since the Applicant did not agree with the foreign group companies on any remuneration in exchange for providing the comfort letters, its income from business relations with the parties related to it was reduced.

11. Accordingly, the Tax Office made, inter alia, income corrections of EUR 15 253 and EUR 22 447 to reflect the notional income that would have been received by the Applicant had it conducted the relevant transactions on arm's-length terms. The Applicant lodged objections to the resulting assessments for business tax for 2003 and to the basis of calculation for business tax in 2003. Those objections were rejected by the Tax Office as unfounded. The action challenging that decision is now pending before the referring court.

12. In its action, the Applicant submits that the Defendant impermissibly increased its taxable income in the amount of (notional) liability remuneration in a manner contrary to EU law. Paragraph 1 of the AStG, it argues, leads to the unequal treatment of cases involving domestic and foreign transactions, since in a case involving purely domestic transactions a notional increase of income would not occur, whereas the granting of guarantees for foreign subsidiaries is 'punished'.

13. In support of its position, the Applicant refers in particular to the Court's judgment in *SGI*.[2] The Applicant's reading of that judgment is that a restriction on the freedom of establishment through a rule requiring correction of profits when benefits are granted to affiliated companies located outside the Member State concerned will be proportionate only if the taxpayer is given an opportunity to provide evidence of commercial justification for any transactions that may not be consistent with the arm's-length principle. Paragraph 1 of the AStG does not contain any express provision concerning the opportunity to present commercial justification in order to explain a transaction that is not made on arm's-length terms. According to the Applicant therefore, it is at variance with the principle of proportionality. The gratuitous granting of the comfort letters in dispute was not carried out for tax reasons. On the contrary, it had to do with supportive actions to replace equity capital. Thus, from the standpoint of EU law, liability remuneration cannot be added on, since there is commercial justification for providing gratuitous security for the loans.

14. In its defence, the Defendant essentially argues that, in the *SGI* case, which dealt with a Belgian tax provision bearing some similarities to Paragraph 1 of the AStG, the Court ruled that Articles 43 and 48 EC do not preclude, in principle, such legal provisions of a Member State. The Defendant acknowledges that Paragraph 1 of the AStG does not contain a separate provision concerning the presentation of evidence of commercial justification. However, it considers that it is always open to the taxpayer to present evidence of reasonableness. If there is commercial justification for departing from what would otherwise be reasonable, such justifications could also be taken into account in the context of Paragraph 1 of the AStG. In addition, under German law, the taxpayer has the option of challenging the tax assessment in both out-of-court and judicial proceedings.

15. In the light of the above, the Finanzgericht Rheinland-Pfalz (Finance Court of the Land of Rhineland-Palatinate) puts the following question to the Court:

'Does Article 49 of the Treaty on the Functioning of the European Union (TFEU), in conjunction with Article 54 TFEU, (formerly Article 43 of the Treaty establishing the European Community (TEC), in conjunction with Article 48 EC), preclude legislation of a Member State which provides that income of a resident taxpayer derived from business relations with a company established in another Member State in which that taxpayer has a direct or indirect shareholding of at least 25% and with which that taxpayer has agreed terms that depart from those that would have been agreed on by unrelated third parties under the same or similar circumstances must be calculated as if that income had been earned pursuant to terms agreed on between unrelated third parties, if such a correction is not made in respect of income from business relations with a resident company and the legislation in question does not afford the resident taxpayer the opportunity to present evidence that the terms were agreed on for commercial reasons resulting from its status as a shareholder of the company established in the other Member State?'

2 Judgment of 21 January 2010 (C-311/08, EU:C:2010:26).

16. Written submissions were lodged by the Applicant, the German and Swedish Governments, and the European Commission. The interested parties that participated in the written stage also presented oral argument at the hearing held on 27 September 2017.

IV. Assessment

17. Can a Member State prevent companies from shifting profits out of its jurisdiction by requiring income to be declared on the basis of 'arm's-length conditions'? Can it impose such a requirement only in relation to cross-border transactions and not domestic ones (that is, between two resident companies) without falling foul of the Treaty rules on freedom of establishment?[3] That is, in essence, the query put by the referring court in this case.

18. My short answer in this case is yes to both points. That is because I do not consider that the national rules in question give rise to any restriction on the freedom of establishment. However, to the extent that they do, they are, in my view, justified.

19. I will begin by setting out in Section A some general observations relating to territoriality of taxation and the approach taken by the Court to the application of the Treaty provisions on freedom of establishment. In Section B, I will recall the main points of the Court's judgment in *SGI*, a key precedent in this case, and then respond to the referring court's question.[4]

A. On territoriality, discrimination, restrictions and comparability

1. Territoriality, profit shifting and base erosion

20. The principle of territoriality of States' powers of taxation is well recognised internationally, including in the Court's case-law.[5] According to that principle, Member States can tax resident companies on their worldwide profits (taxation based on residence) and non-resident companies on the profits of their activities in that state (taxation based on source).

21. One of the consequences of the principle of territoriality is that companies are not free to shift profits and losses between tax jurisdictions at will. That has repeatedly been recognised in the Court's case-law, in particular through application of the concept of the 'balanced allocation of the powers of taxation'.[6] In applying that latter concept, the Court has confirmed that if a Member State were required to accept the free transfer of profits of resident companies outside its jurisdiction, it 'would be forced to renounce its right, in its capacity as the State of residence of that company to tax its income in favour, possibly, of the Member State in which the recipient company has its establishment'.[7]

3 The national rules at issue apply to holdings of between 25% and 100%, which clearly include situations of 'definite influence' (see, for example, judgment of 13 November 2012, *Test Claimants in the FII Group Litigation* (C-35/11, EU:C:2012:707)). Moreover, the applicant has a 100% holding in the foreign group companies in the present case. The referring court's question relates to the freedom of establishment only. As a result, and without excluding the potential application of the rules of free movement of capital in this case, the national rules will be analysed here only in the light of the Treaty provisions on freedom of establishment. In relation to the freedom of establishment, the referring court's question refers both to Articles 43 and 48 EC and Articles 49 and 54 TFEU. The facts of the case date from 2003. As a result, the relevant Treaty provisions on freedom of establishment are, strictly speaking, Articles 43 and 48 EC, although there is no material difference in this case.

4 Judgment of 21 January 2010 (C-311/08, EU:C:2010:26).

5 Judgments of 15 May 1997, *Futura Participations and Singer* (C-250/95, EU:C:1997:239, paragraph 22), and of 13 December 2005, *Marks & Spencer* (C-446/03, EU:C:2005:763, paragraph 39).

6 Judgments of 13 December 2005, *Marks & Spencer* (C-446/03, EU:C:2005:763, paragraph 46); of 29 November 2011, *National Grid Indus* (C-371/10, EU:C:2011:785, paragraph 45); and of 6 September 2012, *Philips Electronics UK* (C-18/11, EU:C:2012:532, paragraph 23).

7 Judgment of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 63).

22. It follows naturally from that observation that Member States can legitimately adopt measures which are designed to prevent the erosion of their tax base through the shifting of profits out of the jurisdiction. They can take steps to ensure that profits are correctly allocated.[8]

23. Erosion of a State's tax base can occur, for example, when resident companies provide goods or services to non-resident companies at an undervalue or free of charge, thus reducing their taxable income in their State of residence. That can be countered by the Member State through the readjustment of the resident company's tax base to reflect what it would have been if the transaction had taken place on arm's-length terms (application of 'transfer pricing'). The arm's-length principle is an international standard set out in Article 9 of the OECD and United Nations model tax conventions and is used by most tax administrations around the world.[9]

24. To clarify, transfer pricing determined on the basis of the arm's-length principle can be used to readjust a company's tax base in case of artificial or abusive conditions deliberately designed to avoid tax. It is also generally and legitimately used as a tool for ensuring a consistent basis for profit allocation (and avoiding double taxation). That is, in my view, important to recall in the present case, since I understand that there is no allegation of tax avoidance or abuse against the Applicant.

25. For transactions that are not made on arm's-length terms between affiliated companies *both resident in the same State*, concerns about base erosion do not arise as they do in cross-border situations. In such cases, profits do not 'escape' the State's tax jurisdiction to go abroad. They are simply shifted within the same tax jurisdiction and can be taxed elsewhere — the tax will be imposed on another taxpayer, but still within the same jurisdiction. Application of transfer pricing is therefore not necessary (or at least in principle would not serve the same ends) in those cases of purely domestic transactions.[10]

26. In the main case, the German Government argues that it is for those reasons that it applies the relevant transfer pricing rules to cross-border situations only. The difference between domestic and cross-border transactions and the limitation of transfer pricing rules to the latter is therefore at the heart of the question raised by the national court.

27. That difference in turn raises issues about the comparability of cross-border and domestic situations, the role of comparability in the application of the rules on freedom of establishment and, more broadly, the way in which those rules are applied in the field of direct taxation. It is to those issues that I now turn.

2. Two approaches and a mix

28. There are two different approaches to analysing situations of alleged infringements of freedom of establishment in the area of direct taxation in the Court's case-law: the discrimination approach and the restriction approach. It is well recognised in academic literature that over the years the Court has vacillated between these approaches.[11]

8 In that regard, the OECD is a key forum for discussion and development of rules on transfer pricing and 'BEPS' (base erosion and profit shifting). See http://www.oecd.org/tax/beps/ and http://www.oecd.org/tax/transfer-pricing/.

9 See, for example, OECD (2012) 'Dealing effectively with challenges of transfer pricing', p. 14, available at http://www.oecd.org/publications/dealing-effectively-with-the-challenges-of-transfer-pricing-9789264169463-en.htm.

10 See, for example, Farmer, P., 'Direct Taxation and the Fundamental Freedoms', *The Oxford Handbook of European Union Law*, Oxford University Press, Oxford, 2015, p. 812: 'Such rules are generally limited to cross-border situations because they would be redundant in domestic ones.'

11 See, for example, Barnard, C., 'The Substantive Law of the EU: The Four Freedoms', 5th ed., Oxford University Press, Oxford, 2016, at p. 399 et seq; Kingston, S., 'The Boundaries of Sovereignty: The ECJ's controversial role applying internal market law to direct tax measures', *Cambridge Yearbook of European Legal Studies*, Vol. 9, 2006.

(a) Discrimination approach

29. Under the *discrimination approach*, in order for a national measure to be found contrary to the freedom of establishment, comparable situations must be treated differently to the disadvantage of companies exercising the freedom of establishment. For example, the situations of, on the one hand, the resident parent with a foreign subsidiary and, on the other, the resident parent with a resident subsidiary must be *comparable*, with the former being *treated less well*.

30. The exercise of comparison in cases of national and multinational groups and direct taxation is not straightforward. One of the key complications is the fact that multiple legal entities are involved. That can lead to a different focus in the comparative exercise.

31. For example, a legal analysis might begin with a comparison of *parent companies*, finding that they are treated the *same* for the purposes of *taxation of profits*, then continue by comparing (resident and non-resident) *subsidiaries* and finding that they are being treated *differently* for the purposes of some *advantage* (such as the right to a tax credit).[12] Similarly, exercises of comparison may begin at the level of *subsidiaries* of resident and non-resident companies, and end with a comparison of national and multinational *groups*.[13]

32. I draw an important conclusion from the latter point. When faced with questions of taxation of groups and freedom of establishment, legal entities are not compared in splendid isolation. They are not compared with total disregard to the circumstances and treatment of related entities. The circumstances and treatment of those related entities should, on the contrary, be relevant and integrated into the legal analysis.

33. That observation is crucial in the present case. It is indeed agreed by all parties that there is a difference in treatment *at the level of the individual legal entity*. However, one of the key arguments of the German Government is that, for cross-border transactions, there is no disadvantage *at the level of the group* — the 'zero sum' argument, that I will return to below.

(b) Restriction approach

34. In comparison to the discrimination approach, the restriction approach is much broader. According to the traditional formula, it covers all rules 'capable of hindering, directly or indirectly, actually or potentially, intra-Community trade'.[14] That formula has, over the years, evolved. In its newer articulation, a restriction would be generally understood as any national measure 'liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty'.[15] It is, however, clear that under the *restriction approach*, even non-discriminatory restrictions must be justified.[16]

12 Judgment of 28 January 1986, *Commission* v *France* (270/83, EU:C:1986:37, paragraphs 20 and 27).

13 Thus, for example, in the *Thin Cap* case, the Court stated that 'the difference in treatment to which the subsidiaries of non-resident parent companies are, by virtue of legislation such as the legislation at issue in the main proceedings, subjected in comparison with subsidiaries of resident parent companies is capable of restricting freedom of establishment even if, from a tax perspective, the position of a multinational group of companies is not comparable to that of a group of companies, each of which is resident in the same Member State'. Judgment of 13 March 2007, *Test Claimants in the Thin Cap Group Litigation* (C-524/04, EU:C:2007:161, paragraph 59). See also below at point 42.

14 Judgment of 11 July 1974, *Dassonville* (C-8/74, EU:C:1974:82, paragraph 5).

15 Judgment of 30 November 1995, *Gebhard* (C-55/94, EU:C:1995:411, paragraph 37). See also, judgment of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 56).

16 Judgment of 15 May 1997, *Futura Participations and Singer* (C-250/95, EU:C:1997:239).

35. Thus, for example, in the *SGI* case, the Court held that the provisions on freedom of establishment 'are directed at ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they *also* prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation' (emphasis added).[17]

36. The restriction approach therefore obviates, in theory at least, the need for any comparison or identification of relatively disadvantageous treatment.

37. A major challenge to the application of the restriction approach to direct taxation is that Member States retain sovereignty in that field. Member States remain free to define the tax base and fix applicable rates. The coexistence of national systems defined and regulated in this way naturally leads to 'restrictions' in the freedom of establishment.[18]

38. To take an extreme example, a company resident in Member State A, which applies a corporate tax rate of 10%, could be deterred from setting up a subsidiary in Member State B, which applies a rate of 20%. If the restriction approach were taken to its logical conclusion, such a difference in tax rate would already amount to a restriction on the freedom of establishment and require Member State B to justify its higher tax rate.

(c) Mixing the approaches

39. At least in part as a result of the difficulties in applying a 'pure' restriction approach to rules on direct taxation, that approach has been diluted with a dose of discrimination. The result is sometimes a strange cocktail.

40. Thus, for example, the Court has on many occasions found that there is a *restriction* on free movement which 'is permissible only if it relates to situations which are not objectively comparable *or* if it is justified by an overriding reason in the public interest' (emphasis added).[19] In such cases, the vocabulary of restriction is used but the approach is ultimately one of discrimination: lack of comparability *will obviate the need to consider justifications*.

41. Alternatively, a difference in treatment is observed but no analysis of comparability is conducted. That is followed by a finding of a 'restriction'. Such an approach can render it ambiguous as to whether the assessment is discrimination or restriction based (as in, for example, the *SGI* case,[20] which is discussed in further detail below).

42. On yet other occasions, there is an explicit acknowledgement of *absence of comparability* and, at the same time, a reference to *difference in treatment*, as in the *Thin Cap* case, which has been quoted above.[21]

43. Such an approach implies that discrimination is not a necessary legal condition for finding an infringement of the freedom of establishment, but nonetheless that it is somehow relevant that two situations are being treated differently.

17 Judgment of 21 January 2010 (C-311/08, EU:C:2010:26, paragraph 39 and the case-law cited).

18 Farmer, P., and Lyal, R., *EC Tax Law*, Clarendon Press, Oxford, 1994, at p. 28: 'Taken to its logical conclusion, an approach focusing on the exercise of a restriction rather than on discrimination would bring all charging provisions in national tax legislation within the scope of the Treaty Articles on the freedoms.'

19 Judgment of 17 December 2015, *Timac Agro Deutschland* (C-388/14, EU:C:2015:829, paragraph 26).

20 Judgment of 21 January 2010 (C-311/08, EU:C:2010:26).

21 See quotation above, footnote 13.

44. In sum, there are specific difficulties involved in applying both the discrimination and the restriction approaches in the area of freedom of establishment to direct taxation. As far as the discrimination approach is concerned, the issue of comparability and in particular what entities and at which stage they are to be compared is not free of controversy. The restriction approach faces even greater problems: in particular, if taken to its full logical conclusion, any difference in direct taxation could be a restriction on freedom of establishment. By definition, the Member States would be always obliged to justify their tax policy. Those difficulties stem in particular from the principle of territoriality as confirmed by the Court and more generally from the degree of sovereignty enjoyed by Member States in that area. As will be seen below, those difficulties also arise in the present case.

B. The referring court's question

1. The SGI *case*

45. The order for reference refers to the *SGI* case[22], as did all the parties in their written and oral submissions. I shall thus begin by recalling the facts and main conclusions of that judgment.

46. SGI was a company established in Belgium. It granted an interest free loan to Recydem, a company belonging to the same group. SGI was issued with a revised tax assessment in which its tax base was increased to reflect notional interest of 5% for the loan to Recydem. The basis for that readjustment was Article 26 of the Code des impôts sur le revenue (Income tax Code). That provision allowed the value of unusual or gratuitous advantages to be added back into the profits of the donor for tax purposes 'unless they are used in order to determine the taxable income of the recipients'. It also provided that the advantage *shall* be added back into the profits of the donor in a number of scenarios, including where the recipient is a related[23] foreign company.

47. The Court held that companies resident in Belgium granting unusual or gratuitous advantages to related foreign companies were at a disadvantage compared with those granting advantages to related companies also resident in Belgium. That situation was liable to deter Belgian companies 'from acquiring, creating or maintaining a subsidiary in another Member State or from acquiring or maintaining a substantial holding in a company established in that state because of the tax burden imposed, in a cross-border situation, on the grant of advantages at which the legislation at issue in the main proceedings is directed'.[24] Moreover, it could deter companies from acquiring, creating or maintaining a substantial holding in Belgium because of the tax burden imposed there on the grant of advantages. That amounted to a restriction on the freedom of establishment.

48. However, the restriction could be justified on the basis of the legitimate objective of preserving the balanced allocation of the powers of taxation. With regard to legitimate objectives, the Court also referred to the prevention of tax avoidance. Since that justification has not been raised in the present case, I will not discuss it in detail here.

49. Companies are not free to shift their profits and losses between Member States at will to minimise their tax burden. To allow resident companies to grant unusual or gratuitous advantages to related foreign companies may well undermine the balanced allocation of the powers of taxation by forcing the Member State of the 'donor' to renounce its right to tax the income of the resident company.[25]

22 Judgment of 21 January 2010 (C-311/08, EU:C:2010:26).

23 In that context, meaning with common interests or in a relationship of interdependence.

24 Judgment of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 44).

25 Judgment of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 63, see full quote above at point 47).

50. The Court also found that, subject to the final assessment of the national court, the measure was proportionate to the extent that corrective tax measures reflected arm's-length conditions and the taxpayer had the opportunity to advance commercial justifications for terms that did not initially appear to be at arm's-length.

2. The present case: a restriction on freedom of establishment?

51. In the present case, the Applicant issued, free of charge, comfort letters containing a guarantee for the benefit of its foreign group companies. It thus granted an advantage to them on terms that were not arm's-length terms.

52. In application of Paragraph 1(1) of the AStG, the Applicant's tax base was readjusted upwards to reflect what its taxable profits would have been if the transactions had been carried out on arm's-length terms.

53. It is common ground that, under German law, such readjustments are carried out only if the recipient company is established in another Member State. By contrast, the tax base of a company resident in Germany is not readjusted where it grants an advantage to a related party which is also resident in Germany.

54. If the Court's reasoning in the *SGI* case were to be applied,[26] it would follow that the tax position of a company resident in Germany which, like the Applicant, grants advantageous terms that are not arm's-length terms to a related party that is established in another Member State, is less favourable than it would be if it granted such an advantage to a related party resident in Germany.

55. However, I consider that such a transposition of the solution in *SGI* is incorrect for two reasons: in the present case there is: (a) absence of discrimination due to both lack of comparability and absence of unfavourable treatment; and (b) inapplicability of the restriction approach. I shall consider each of these in turn below.

(a) Absence of discrimination

(1) Lack of comparability

56. An important difference between the present case and the *SGI* case is that in *SGI* the issue of comparability of situations was apparently not discussed. In *SGI* differential treatment was acknowledged in the judgment but no assessment of comparability was conducted. However, in the present case, Germany explicitly argues that there is an absence of comparability requiring the Court to address the issue head-on.

57. According to settled case-law, the comparability of a cross-border situation with an internal situation must be examined having regard to the *aim pursued* by the national provisions at issue.[27]

58. In the present case, I understand on the basis of the written submissions of the German Government that the purpose of the relevant provisions of national law is to ensure that profits generated in Germany are not transferred outside Germany's tax jurisdiction, via transactions that are not carried out on arm's-length terms, without being taxed.

26 Judgment of 21 January 2010 (C-311/08, EU:C:2010:26, paragraph 43).

27 See, for example, judgments of 18 July 2007, *Oy AA* (C-231/05, EU:C:2007:439, paragraph 38), and of 25 February 2010, *X Holding* (C-337/08, EU:C:2010:89, paragraph 22).

59. On that basis, there would appear to be strong arguments that the cross-border and domestic situations are not in fact comparable in this case. In the cross-border situation, failure to readjust the tax base to reflect arm's-length terms would involve Germany renouncing its rights, in its capacity as the State of residence of the company, to tax its full income. That contrasts with the domestic situation, where the revenue remains within the jurisdiction.

60. Thus, the argument essentially is that for the specific purpose of making sure that tax does not escape the jurisdiction of a Member State, foreign and domestic subsidiaries are not comparable. The legislation at hand was adopted specifically *because* they are not seen as the same. The principle of territoriality and the inability to exercise jurisdiction to tax over foreign subsidiaries renders those two situations objectively different. Inequality consists not only in treating the same situations differently, but also treating objectively different situations in the same way. [28]

61. Two points are worth highlighting in that regard. First, this argument shows quite clearly, in general but also and perhaps even more strongly in the specific context of this case, how deeply intertwined the assessments of comparability and justification are. In spite of being presented as two distinct steps of the test, in its practical operation, the establishment of comparability can take into account the purpose of national legislation when defining the *tertium comparationis*. The same purpose is also referred to in the assessment of the justification of the Member States' action. Second, such a 'telescoping' of comparability and justification will typically be present when EU law review of national measures takes place. Provided that the national measure in question is not drafted in an unduly narrow or unreasonable way, the comparability framework established by national law is also likely to be of particular significance for establishing a comparability framework under EU law, on the condition that the aim pursued by the national law is itself acceptable from the perspective of the European Union. Thus, the national law framework is likely to be taken as a starting point, although it is not necessarily the decisive argument, for establishing comparability under EU law. [29]

62. That is precisely the scenario in which this case falls. If one accepts the principle of (tax) territoriality, as well as the objective of 'preserving the balanced allocation of the powers of taxation' (which effectively means the same, expressed at the level of 'justification') then the situations of domestic and foreign subsidiaries become incomparable.

63. I therefore consider that Germany's position that the cross-border and domestic situations are simply not comparable is correct. The purpose for which such a differentiation was established under national law is licit from the point of view of EU law and the difference made in national law is reasonable. It would indeed be paradoxical for the Court to solemnly acknowledge 'the principle of territoriality enshrined in international tax law and recognised by Community law' [30] and, at the same time, to hold that one can completely assimilate the transfer of revenues outside a Member State's tax jurisdiction with transfers inside that Member State's tax jurisdiction.

64. Nor indeed does the Court's case-law support such assimilation.

28 In the context of annual tax on foreign and national undertakings for collective investment, see my Opinion in *NN (L) International* (C-48/15, EU:C:2016:45, point 57).

29 For similar considerations in the discussion of selectivity in the context of State aid, which also encompasses considerations of comparability, see my Opinion in *Belgium* v *Commission* (C-270/15 P, EU:C:2016:289, points 40 to 46).

30 Judgment of 13 December 2005, *Marks & Spencer* (C-446/03, EU:C:2005:763, paragraph 39).

65. It is correct that invoking the prevention of profit shifting between Member States is not a blank cheque. It does not mean that the ‘rules adopted by a Member State for the specific purpose of dealing with the situation of multinational groups may not, in some cases, constitute a restriction on the freedom of establishment’.[31] However, the conditions for finding a restriction must actually be fulfilled. Comparability and disadvantageous treatment must actually be established.[32]

66. In the present case, in particular having regard to the purpose of the national rules at issue, I do not see that there is a case for comparability. Thus, the present case contrasts with situations where the Court has been faced with the argument of territoriality being invoked in the context of a measure *not* specifically designed to deal with cross-border leakage of taxable income.[33]

67. Moreover, in a number of cases the Court has held that a key factor in determining comparability is that a Member State seeks to tax residents and non-residents in the same way. Thus, for example, as soon as a Member State ‘imposes a charge to income tax not only on resident shareholders but also on non-resident shareholders in respect of dividends which they receive from a resident company, the position of those non-resident shareholders becomes comparable to that of resident shareholders’.[34]

68. In the present case, as pointed out by the German Government, there is no attempt to tax non-residents. Taxation is imposed on the basis of the arm’s-length principle and, therefore, on the profits generated in Germany only. On that basis, the cross-border and domestic situations are again not comparable.

69. In the light of the foregoing, I do not consider that in the present case the situations of resident companies with non-resident subsidiaries and resident companies with resident subsidiaries are comparable for the purposes of identifying any discrimination that might infringe the freedom of establishment. The situations are objectively different. That indeed means that they *cannot* be treated in the same way, if the principle of non-discrimination underlying the rules on freedom of establishment is to be respected.

(2) Absence of less favourable treatment

70. Nonetheless, if it were to be considered that the cross-border and domestic situations are in fact comparable in this case, I consider that there is also a strong argument that there is no discrimination, in the sense of less favourable treatment of the former.

71. That is based primarily on an argument made by the German Government. I shall refer to it as the ‘zero sum’ argument. According to the latter, in the case of transactions that are not at arm’s-length between parent and subsidiary companies, which are both resident in Germany, profits are not taxed in the hands of the parent but they will be in the hands of the subsidiary. As a result, on a global view of the group, the tax burden remains the same. There is no point in readjusting the tax bases of the parent and subsidiary (if both are based in Germany) to reflect arm’s-length terms, because that would be administratively cumbersome and yield the same result in practice.

31 Judgment of 13 March 2007, *Test Claimants in the Thin Cap Group Litigation* (C-524/04, EU:C:2007:161, paragraph 60).

32 Admittedly, if the Court wished to explicitly endorse a ‘pure’ restriction approach in the area of freedom of establishment and direct taxation, such a development would obviate the need for any further assessment of comparability and disadvantageous treatment. However, not only would that entail all the disadvantages mentioned above, but it would also be contrary to the movement in the opposite direction by the Court in recent years. The judgment of 5 July 2005, *D* (C-376/03, EU:C:2005:424) is often cited as a ‘turning point’ in that regard (see, for example, Kingston, S., ‘The Boundaries of Sovereignty: The ECJ’s controversial role applying internal market law to direct tax measures’, *Cambridge Yearbook of European Legal Studies*, Vol. 9, 2006, p. 303).

33 Judgment of 18 July 2007, *Oy AA* (C-231/05, EU:C:2007:439).

34 See, for example, judgment of 12 December 2006, Test Claimants in Class IV of the ACT Group Litigation (C-374/04, EU:C:2006:773, paragraph 68).

72. In other words, the German Government is arguing that there is no difference in treatment because in both cases, profits generated on the national territory are taxed once, always once, and only once.

73. A similar argument was raised in the *SGI* case. In response to it, the Court implicitly acknowledged that (in cases of 100% ownership) the zero sum argument could be correct. [35]

74. However, the Court did not consider that argument in detail, since there was in any event a risk of double taxation. That is because, in *SGI*, the upward readjustment of the tax base of the company granting the advantage in Belgium might not be reflected by a downward readjustment of the tax base of the recipient company in France. That risk was not eliminated by the possibility to apply the Arbitration Convention 90/436/EEC to avoid double taxation, since application of that instrument entailed cost and delay. [36] On that basis, the restriction on the freedom of establishment was confirmed.

75. As regards the risk of double taxation, I find that reasoning highly problematic in the present case. As explained above, according to the principle of territoriality, Member States can tax resident companies on their worldwide profits (taxation based on residence) and non-resident companies on the profits of their activities in that state (taxation based on source). One of the corollaries of those dual criteria of residence and source for asserting taxing rights is the risk of double taxation. A taxpayer in Member State B receiving a dividend from Member State A may be taxed twice. A withholding tax may be applied in Member State A (source), and those profits may then be taxed in the recipient's State of residence, Member State B. [37]

76. Notwithstanding all of that, in accordance with the Court's established case-law, there is no obligation for the source state to grant tax relief in such cases. [38] Thus, double taxation or the risk thereof does not cancel out the principle of territoriality. It does not prevent Member States from imposing taxes on profits in their jurisdiction.

77. However, the reasoning in *SGI*, in my view, implies the opposite. That judgment takes a situation where a Member State insists on taxing the profits generated on its territory and transforms it into a disadvantage by citing the risk of double taxation.

78. Pushing that reasoning to its logical conclusion and applying it to the present case serves to highlight its internal inconsistencies.

79. In the present case (as in the *SGI* case) the key concern that comes back repeatedly is that arm's-length pricing is being applied to cross-border, but not domestic, situations. The difficulty I perceive with the argument about the risk of double taxation is that it persists *even if the difference in treatment is eliminated*. Thus, in the present case, if the German Government had chosen to apply transfer pricing to cross-border and domestic transactions then there would have been no difference in treatment. However, *there would still be a theoretical risk of double taxation* in the case of cross-border situations, which in principle simply does not exist in domestic transactions.

35 Judgment of 21 January 2010 (C-311/08, EU:C:2010:26, paragraph 45).

36 Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (OJ 1990 L 225, p. 10) contains arbitration mechanisms aimed at avoiding double taxation of that type (see, in that regard, judgment of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 54)).

37 Farmer, P., 'Direct Taxation and the Fundamental Freedoms', *The Oxford Handbook of European Union Law*, Oxford University Press, Oxford, 2015, p. 812.

38 Judgment of 14 November 2006, *Kerckhaert and Morres* (C-513/04, EU:C:2006:713, paragraphs 22 to 24).

80. In my view, the real issue in the present case is rather the validity of the 'zero sum' argument. If that argument is valid, it seems to me that any risk of double taxation is simply a result of the coexistence of different tax systems and the principle of territoriality itself. It would be present regardless of the scenario.

81. In the present case, and subject to potential verification by the national court, the zero sum argument does appear to hold. In that regard I note the following.

82. First, at the hearing before this Court, neither the Applicant nor the Commission have seriously brought the argument into question. At no stage has it been contested that application of the arm's-length criteria in the case of domestic transactions would increase the tax burden of the resident companies overall, or that non-application of it lightens their tax burden.

83. Second, the zero sum argument clearly involves consideration of taxation of the group at a global level. For the reasons set out above at points 30 to 33, not limiting the analysis of discrimination to the specific circumstances of individual legal entities, is, in my view, justified (and indeed commonplace in the case-law).

84. Third, in *SGI* it was implied in the Court's judgment, and developed in the Advocate General's Opinion, [39] that the zero sum argument only works if there is 100% ownership. In such cases it will not matter which company in the group is taxed. However, in cases of lower levels of interest, that is not so obvious.

85. In response to that contention, I would simply observe that, in the present case, the Applicant does own, directly or indirectly, 100% of the foreign group companies. In accordance with the Court's own reasoning in *SGI*, it is therefore a situation where in principle the zero sum argument 'works'.

86. In the light of the foregoing, I consider that in the present case there is either an absence of comparable situations or, alternatively, if there is comparability, there is, in any event, no disadvantage. As a result, the national measure at issue would not give rise to a discrimination infringing the freedom of establishment.

(b) Absence of a restriction

87. Section (a) above assumes that the 'discrimination approach' applies in this case. However, if it is considered that the restriction approach should apply, that would in principle obviate the need for any comparison or identification of a relative disadvantage.

88. Such a proposal nonetheless raises a rather tricky question of principle: can the requirement for companies to calculate their tax base on the basis of arm's-length conditions really be viewed as a restriction on freedom of establishment? [40]

39 Opinion of Advocate General Kokott (C-311/08, EU:C:2009:545, point 45).

40 I also note that the Commission's position on this issue in the present case appears to me arguably to be somewhat in contradiction with its approach to issues of transfer pricing in the field of State aid. In that regard, it has indeed been actively pursuing actions against a number of Member States specifically because they allegedly failed correctly to apply transfer pricing to cross border transactions, *with the result that resident companies were undertaxed*. In my view, that renders all the more surprising the proposal that Germany could conceivably resolve the issue either by applying transfer pricing to all transactions (cross-border and domestic) or to none.

89. In my view, it cannot. It is nothing more than an expression of the principle of territoriality of taxation, reflecting a State's right to tax profits generated within its jurisdiction.[41] Indeed, if it were otherwise and readjustment of the tax base to reflect arm's-length terms were to constitute a restriction on freedom of establishment, then arguably a Member State's application of anything above a zero rate of taxation could also be. In other words, the problems inherent to the application of the restriction model to direct taxation crop up again.

90. At this stage, I consider it also important to address the arguments raised in *SGI* in relation to 'deterrence'. I have paraphrased these above at point 47. Essentially, the idea is that the application of arm's-length conditions somehow constitutes a deterrent for (in this case) German companies thinking of creating subsidiaries abroad and for non-German companies thinking of creating subsidiaries in Germany.

91. However, as applied to the present case that conclusion would, in my view, amount to little more than a (rather questionable) hypothesis. In what way would there be a deterrent effect? That hypothesis appears critically to depend on a major supposition: that a company would be deterred from exercising its freedom of establishment by the prospect of having to pay tax on all its profits, as readjusted to reflect arm's-length terms.[42] If the principle of territoriality and the sovereignty of Member States in direct taxation are to retain any meaning at all, that does not appear to me to be a legitimate basis for a finding of infringement of the freedom of establishment.

92. For those reasons, and in the absence of any discriminatory treatment of comparable situations, I do not consider that Germany's readjustment of the tax base of resident companies to reflect arm's-length terms in cross-border transactions in itself constitutes a restriction of the freedom of establishment.

93. However, if the Court were to come to a different conclusion, I consider that the restriction would be justified.

3. Justification

94. Restrictions on the freedom of establishment are permissible if they pursue a legitimate objective and are justified by overriding reasons in the public interest. Application must also be appropriate to attain the objective and not go beyond what is necessary.[43]

(a) Legitimate objective

(1) Balanced allocation of the powers of taxation

95. In the present case, the German Government invokes a single justification, namely the balanced allocation of the powers of taxation between Member States.

96. The Court has acknowledged on several occasions that that can constitute a legitimate objective capable of justifying restrictions on the freedom of establishment.[44]

41 See above points 20 to 27.

42 That is, of course excluding any consideration of difference in treatment, since that is an issue of relevance in the context of the discrimination model.

43 Judgment of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 56 and the case-law cited).

44 Judgment of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 60 and the case-law cited).

97. The underlying logic is, again, that companies are not completely free to shift their profits between jurisdictions at their leisure, since that could erode the tax bases of certain Member States and thus 'undermine the balanced allocation of the power to impose taxes between the Member States, since the tax base would be increased in one of the States in question and reduced in the other'.[45]

98. That logic is, in my view, clearly transposable to the present case. The national legislation at issue is specifically designed to prevent 'leakage' of taxable income from Germany's tax jurisdiction, as a result of dealings between related companies in foreign states that are not conducted on arm's-length terms.[46]

(2) Granting of advantages and shifting of profits

99. It has been argued by the Commission in particular that the balanced allocation of the powers of taxation cannot apply as a justification in the present case (or its application is disproportionate) because of the nature of the transactions at issue. Essentially, the argument is that unlike, for example, a straightforward cash transfer or interest-free loan, the advantage in this case is not so obvious or at least difficult to price.

100. I find that argument questionable on a number of levels. First, it appears to me impossible to deny that the provision of a guarantee like the one given by the Applicant in its comfort letter has a very real economic value and, in relation to unrelated companies, would be paid for. That fact is explicitly confirmed in the OECD's guidelines on transfer pricing[47] and, in relation to guarantees provided by the State, in the Commission's own communication on State guarantees.[48]

101. Second, as regards the alleged difficulties in putting a value on such guarantees, pricing models clearly exist to do so. They can also be found, in particular, in the OECD guidelines. The aforementioned Commission communication indeed also contains pricing for guarantees granted by Member States.

102. Moreover, at the hearing the German Government stated, without being contradicted by the Applicant, that the disagreement in this case is *one of principle not of price*. The parties to the main case agree on the rate that should be applied *if* it is found that application of transfer pricing to such cases is compatible with EU law.

103. In the light of the foregoing, I consider that legislation such as that at issue in the main proceedings pursues legitimate objectives, which are compatible with Article 49 TFEU and constitute overriding reasons in the public interest, and that they are appropriate for ensuring the attainment of those objectives.

(b) Proportionality

104. In principle, in order for a measure that is considered to be a restriction on the freedom of establishment to be justified, it must not only pursue a legitimate aim, but also be proportionate. The *means* must not go beyond what is necessary to achieve the *aim*.

45 Judgment of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 62 and the case-law cited).

46 In the *SGI* case, the Court held that the balanced allocation of the powers of taxation and the need to prevent abuse were, 'taken together' a legitimate objective. However, it is equally apparent from other case-law that the balanced allocation of the powers of taxation can be invoked as a *stand-alone* justification (see in that regard, for example, judgment of 18 July 2007, *Oy AA* (C-231/05, EU:C:2007:439)). That point was also acknowledged by the Commission at the oral hearing.

47 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017 at point 7.13. In the oral hearing, the exact nature of a comfort letter or letter of intention was discussed. It was confirmed that in this case, the letter contained a guarantee that was legally enforceable against the Applicant.

48 Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (OJ 2008 C 155, p. 10).

105. That raises a thorny question in the area of direct taxation. Either a tax is justified or it is not. There is no ‘middle ground’. If the *aim* is to tax, then the *means* are to impose and to collect the tax, the whole tax and nothing but the tax. What then, in such a context, would a discussion of ‘less restrictive means’ to achieve the same aim mean? To tax only half the income? To grant a partial rebate of say 20%? It is quite clear that such a discussion could quickly turn into judicial setting of tax rates.

106. I will return to that broader conceptual issue below in the closing section. In the meantime, the Applicant and the Commission in their written and oral pleadings raised three arguments under the heading of ‘proportionality’, none of which I consider to actually be issues of proportionality, but which I nonetheless deal with in turn below.

(1) Application of the arm’s-length principle to comfort letters

107. At the oral hearing, the Commission opined in essence that the application of the arm’s-length principle was a little ‘over the top’[49] since it concerned a mere comfort letter. By implication therefore, ‘proportionality’ from this vantage point should mean certain ‘legislative proportionality’ — the Member State should, presumably, only legislate with regard to direct money transfers, and leave the rest out.

108. As stated above,[50] such letters (at least to the extent they are legally binding and provide financial guarantees, as in this case) clearly have an economic value. That much was indeed ultimately conceded by the Commission.

109. On that basis alone, I see no reason to consider application of the arm’s-length principle to those particular situations as somehow exaggerated. Moreover, and again contrary to the Commission’s arguments, there are absolutely no grounds for arguing that the application of arm’s-length terms would be disproportionate in cases where those terms are difficult to assess.

110. More fundamentally, I do not consider these to be questions of proportionality at all. Either the arm’s-length principle is accepted (warts and all) or it is not. The question is a binary one. It would be a recipe for extreme legal uncertainty if alleged practical difficulties in relation to the application of that principle to very specific cases — cases that are, I would add, explicitly provided for in the international guidelines on the subject[51] — were to constitute valid grounds for rejecting it as disproportionate.

(2) Commercial justifications

111. In the present case, one of the issues raised in the written pleadings of the Applicant and the Commission in relation to proportionality is the extent to which it is possible to give commercial justification for the terms on which a transaction was concluded and the type of commercial justifications that are considered legitimate.

112. The real issue in the present case appears rather *what type* of commercial justification is acceptable and accepted. On that point, the position of the Applicant and the Commission is essentially that companies should be able to justify the terms of their transactions with reference to their particular relationship with the counter party. In other words, they must be allowed to avoid the readjustment of their tax base by justifying the grant of favourable commercial terms with reference to the importance of ensuring the success of their subsidiary.

49 My paraphrasing.

50 Point 100 of this Opinion.

51 Above footnote 47.

113. In my view that argument is clearly incorrect. Were it to be otherwise, the notion of arm's-length transaction would be emptied of any meaning. It would effectively mean a blunt and full exclusion of any business transactions with subsidiaries from the application of the principle, because a parent will *always* have interest in seeing its subsidiary prosper. There would thus always be, by definition, a justification.

114. In other words, there is simply an irreconcilable contradiction between, on the one hand, the proposition that Member States can readjust transactions to reflect fictional terms that *would have* been agreed between *wholly independent* entities and, on the other, that parties can counter by arguing that the terms were different and justified precisely because the entities were connected, having interdependent interests.

115. Finally, these are, to my mind, once again not issues of proportionality, but, rather, questions either about (a) the actual meaning of the principle (and as stated above, in my view, it clearly does not involve consideration of intragroup interests), or (b) whether the principle is *being applied correctly in a specific case.*

(3) Proportionality and differences in treatment

116. I return now to the issue of different treatment between domestic and cross-border transactions. In the present case, the existence of that difference in treatment was firstly relied on to help support a finding of a restriction.

117. At the oral hearing, it was again invoked in the analysis of proportionality: the legislation issue is disproportionate because it treats transactions differently.

118. I find that argument unconvincing for a number of reasons.

119. As a first point, I again refer to the *SGI* case. There was, in that case, readjustment of the tax base to reflect arm's-length terms only in case of cross-border transactions.[52] That difference in treatment did not prevent the Member State invoking the balanced allocation of the powers of taxation as a legitimate objective. Nor did it prevent the finding that the measure was proportionate. Indeed, in its analysis of proportionality in *SGI*, the Court does not even mention the difference in treatment.

120. More to the point, it is unclear how the difference in treatment leads to the conclusion that the measure goes beyond what is necessary to achieve the balanced allocation of the powers of taxation or what other less restrictive measure could have been adopted. In that regard, I fail to see how the measure would become less restrictive of the freedom of establishment if it were to be extended to domestic transactions.

121. In theory at least, the imposition of transfer pricing which has the effect of readjusting upwards the tax base of German companies with foreign subsidiaries could deter the acquisition, creation or maintenance of those subsidiaries.[53] However, the application of transfer pricing also in the case of transactions between related German companies would not appear to reduce or remove that deterrence in any way.

52 As confirmed at paragraph 42 of the judgment of 21 January 2010 (C-311/08, EU:C:2010:26): 'advantages granted by a resident company to a [related] company … are added to the former company's own profits *only if the recipient company is established in another Member State*' (emphasis added).

53 Judgment of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 44 and the case-law cited).

122. It might be retorted that the issue is rather one of 'relative' deterrence or disadvantage caused by the difference in treatment. In other words, if a German company has the choice between, on the one hand, creating a subsidiary abroad (which may result in adjustment of its tax base in relation to any non-arm's-length transactions with that subsidiary, as in the present case) and, on the other, creating a subsidiary in Germany (where no such adjustment will be made), it is more likely to opt for the latter.

123. The basic problem with that argument is that it artificially focuses on the taxation of the parent company and excludes consideration of the subsidiary.[54] *Of course*, if the tax base of the parent can be adjusted upwards *only* the case of non-arm's-length transactions with foreign subsidiaries, there is theoretically a 'tax advantage' for the parent company with a domestic subsidiary. However, that tax advantage resulting from the smaller tax base of the parent will in principle be offset by a larger tax base of the subsidiary. In other words, one finds that we are back to the 'zero sum' argument of the German Government in this case.[55]

124. It is worth recalling that the 'zero sum' argument is also present in the *SGI* case (albeit not by that name). Thus, the Belgian legislation in that case provided that 'a resident company is not taxed on [an unusual or gratuitous] advantage if the advantage is granted to another [related] resident company *… provided that the advantage is used in order to determine the taxable income of the recipient company*'.[56] In other words, the zero sum nature of the transfer from a fiscal point of view was explicitly written into the legislation as a requirement. Belgium was prepared not to tax the 'shifted profit' in the hands of the parent, provided it was being taxed by Belgium in the hands of the subsidiary.

125. To the best of my understanding, it is true that, in the present case, no equivalent condition exists in German legislation. Thus, the German legislation at issue in the main case does not formally require that the 'profits shifted' to the subsidiary resident in Germany must be taxed in the hands of the latter, as a precondition to not readjusting the tax base of the parent. However, nor was any convincing argument made that such 'profits shifted' between German companies as a result of non-arm's-length dealings would not be taxed (or would be taxed less or at a lower rate) in the hands of the recipient.[57]

(4) Size of the correction

126. Finally, I understand that the corrective tax measures adopted by Germany in cases such as the present are confined to the part which exceeds what would have been agreed if the companies did not have a relationship of interdependence. There is no 'overcorrection' that would artificially swell the tax base of the resident German company.[58] However, once again I do not consider that to be a question of proportionality and part of a justification for the national measure, but rather one pertaining to the *correct application* of the arms-length principle.[59]

54 Such an approach is in my view also internally inconsistent. Restrictions on the freedom of establishment are being assessed from the perspective of the advantages and disadvantages in setting up a separate entity (branch or subsidiary) abroad. Yet when it comes to justifying restrictions, one is expected to confine one's assessment to the advantages and disadvantages of the parent company itself.

55 See above at points 71 and 72.

56 Judgment of 21 January 2010 (C-311/08, EU:C:2010:26, paragraph 42). Emphasis added.

57 There was some discussion on the later taxation of distributions by the subsidiary. However, that is, to my mind, an entirely separate issue. The Commission also floated the idea that the taxation of profits in the hands of parents rather than subsidiaries might result in the shifting of profits between *Länder*, where different tax rates apply. However, apart from the fact that no specifics were given at all, the basic federal business tax rate is non-progressive and identical across Germany.

58 Judgment of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 72 and the case-law cited).

59 In that regard, see above at point 115.

4. Conclusion

127. On the basis of the above arguments, legislation of the type at issue in the present case does not, in my view, constitute a restriction on the freedom of establishment. However, to the extent that it does, it is justified on the basis of the preservation of the balanced allocation of the powers of taxation between Member States and, subject of course to the final assessment by the national court, does not go beyond what is necessary to achieve that aim.

5. A postscript

128. Two options were outlined in this Opinion. First, if the discrimination logic is embraced, then there is absence of comparability. The analysis can stop there. Second, if the restriction approach is embraced, then, on a very generous understanding (which would nonetheless have some uneasy general implications for the area of direct taxation), there could theoretically be a hindrance. But that hindrance is justified.

129. Both of these options start from the assumption that the principle of tax territoriality and its emanation in the form of the preservation of the balanced allocation of the powers of taxation between Member States is accepted. The Court's case-law clearly confirms that the Member States have the power to impose direct taxes and that they may do so in relation to profits generated within their jurisdiction, in accordance with the principle of territoriality. Moreover, the arm's-length principle is internationally recognised as a valid means of allocating profits geographically.

130. Starting from that common assumption, there is a difference between the two options as regards the way in which that principle is incorporated into the test. Under the discrimination approach, it is at the stage of comparability. Under the restriction approach, it is first excluded, since comparability is irrelevant in that context. However, the same principle of territoriality then comes back in full force at the stage of justification (in the guise of the 'balanced allocation of the powers of taxation').

131. The argumentative 'exercise in alternatives' carried out intentionally in this Opinion highlights a number of fundamental conceptual problems that the Court's case-law faces in this area. One in particular stands out: with the Court's lack of clarity and oscillation between the discrimination approach, the hindrance approach, and the mix between the two, it may well happen that the two options become mixed. The same argument and the same discussion are then carried out repetitively, at different stages of the test. As was seen in particular in this case, effectively the same argument was invoked and the discussion has taken place at the stage of comparability, justification, and also, as invoked by the Commission and the Applicant, at the stage of proportionality, adding a whiff of circularity to the entire argument.

132. In the light of the foregoing considerations, I would invite the Court to provide two clarifications. First, to clearly articulate which is the approach to freedom of establishment in the area of direct taxation. For a number of reasons suggested in this Opinion, it ought to be, from my point of view, the discrimination approach.

133. Second, if the discrimination approach were embraced and applied in this case, the analysis should stop at the stage of comparability. From a systemic point of view, Member States' insistence on taxing cross-border transactions in accordance with the principle of tax territoriality and recognised international principles applicable in this field cannot in my opinion be considered as anything requiring justification. The mere failure to readjust profits to reflect arm's-length terms between companies both resident in the same Member State does not change that conclusion.

134. The situation might only be different if transactions between resident companies somehow enjoyed lower taxation *overall*. If, as result of different rules applicable, there would be tax distortion, thus creating tax discrimination. However, even then, the question would arise as to precisely what the source of that tax advantage was. In the present case, no overall tax advantage *arising from the non-application of the arm's-length principle* to resident subsidiaries was identified at all.[60]

V. Conclusion

135. In the light of the foregoing, I propose that the Court answer the question of the Finanzgericht Rheinland-Pfalz (Finance Court of the Land of Rhineland-Palatinate, Germany) as follows:

Article 49 of the Treaty on the Functioning of the European Union (TFEU), in conjunction with Article 54 TFEU, (formerly Article 43 of the Treaty establishing the European Community (TEC), in conjunction with Article 48 EC), does not preclude legislation of a Member State which provides that income of a resident taxpayer derived from business relations with a company established in another Member State in which that taxpayer has a direct or indirect shareholding of at least 25% and with which that taxpayer has agreed terms that depart from those that would have been agreed on by unrelated third parties under the same or similar circumstances must be calculated as if that income had been earned pursuant to terms agreed on between unrelated third parties, even if such a correction is not made in respect of income from business relations with a resident company and the legislation in question does not afford the resident taxpayer the opportunity to present evidence that the terms were agreed on for commercial reasons resulting from its status as a shareholder of the company established in the other Member State.

60 The existence of tax advantages 'downstream', pertaining to *separate* transactions (for example, to the distribution of dividends) is a different issue.