Reports of Cases

JUDGMENT OF THE COURT (Grand Chamber)

24 February 2015 *

(Reference for a preliminary ruling — Free movement of capital — Direct taxation — Income tax — Deductibility of support payments made in consideration for a gift by way of anticipated succession — Exclusion of non-residents)

In Case C-559/13,

REQUEST for a preliminary ruling under Article 267 TFEU from the Bundesfinanzhof (Germany), made by decision of 14 May 2013, received at the Court on 30 October 2013, in the proceedings

Finanzamt Dortmund-Unna

v

Josef Grünewald,

THE COURT (Grand Chamber),

composed of V. Skouris, President, K. Lenaerts, Vice-President, A. Tizzano, R. Silva de Lapuerta, M. Ilešič, A. Ó Caoimh, J.-C. Bonichot (Rapporteur), Presidents of Chambers, A. Arabadjiev, C. Toader, M. Safjan, D. Šváby, M. Berger, A. Prechal, E. Jarašiūnas and C.G. Fernlund, Judges,

Advocate General: P. Mengozzi,

Registrar: M. Aleksejev, Administrator,

having regard to the written procedure and further to the hearing on 16 September 2014,

after considering the observations submitted on behalf of:

— the Finanzamt Dortmund-Unna, by S. Lorenz, acting as Agent,

— the German Government, by T. Henze and K. Petersen, acting as Agents,

— the French Government, by D. Colas and J.-S. Pilczer, acting as Agents,

— the European Commission, by G. Braun and W. Roels, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 18 November 2014,

gives the following

* Language of the case: German.

Judgment

1 This request for a preliminary ruling concerns the interpretation of Article 63 TFEU.

2 The request has been made in proceedings between the Finanzamt Dortmund-Unna (Dortmund-Unna Tax Office; 'the Finanzamt') and Mr Grünewald concerning the Finanzamt's refusal, on the ground that Mr Grünewald is not resident in Germany, to allow the deductibility, for the purposes of tax on income from shares in a partnership under civil law received as a gift by way of anticipated succession, of support payments that Mr Grünewald had made to his parents in consideration for that transfer of shares.

Legal context

3 Paragraph 1 of the Law on Income Tax (Einkommensteuergesetz), in the version applicable to the dispute in the main proceedings (BGBl. 2002 I, p. 4210; 'the EStG'), provides that natural persons who have their domicile or habitual residence in Germany are to be fully liable in respect of income tax, whereas those who are not domiciled or habitually resident in Germany are to have limited income tax liability where they receive income of German origin for the purposes of Paragraph 49 of the EStG.

4 Paragraph 10(1) of the EStG is worded as follows:

'The following expenses shall constitute special expenditure where they are not business or occupational expenses:

...

1a. annuities and permanent burdens based on specific obligations, which have no economic link to income which is not taken into consideration in the assessment of tax …'

5 Income coming under Paragraph 49 of the EStG includes income generated by an industrial or commercial activity in Germany.

6 Paragraph 50(1) of the EStG provides:

'Persons with limited tax liability may deduct business expenses (Paragraph 4(4) to (8)) or occupational expenses (Paragraph 9) only to the extent that those expenses are economically linked to income of German origin. ... Paragraphs ... 10 [et seq.] do not apply.'

The dispute in the main proceedings and the question referred for a preliminary ruling

7 By a transfer agreement of 17 January 1989, in the context of a gift by way of anticipated succession, Mr Grünewald acquired from his father a 50% share in a civil-law partnership (Gesellschaft bürgerlichen Rechts) active in the fruit and vegetable sector and located in Germany, with his brother receiving the other half. In consideration for those gifts, the recipients were to pay to their father — or, as appropriate, to their parents — the annuities defined in section 2 of that agreement.

8 Mr Grünewald, who lives in a Member State other than the Federal Republic of Germany and who is neither domiciled nor habitually resident in Germany, earned income between 1999 and 2002 from a business activity on the basis of that shareholding. He also earned other income in Germany.

9 The Finanzamt took the view that Mr Grünewald was partially liable for tax, and on the basis of Paragraph 50 of the EStG, it refused to allow him to deduct from his taxable income in Germany the annuities that he had paid to his parents who were resident in Germany.

10 Mr Grünewald's appeal against that decision was upheld by judgment of the Finanzgericht Münster (Münster Finance Court).

11 The Finanzamt applied to the Bundesfinanzhof (Federal Finance Court; or 'the referring court') to have that judgment set aside and for the action to be dismissed.

12 The referring court believes that the Finanzamt was right to refuse, in accordance with the applicable national law, deduction of the support payments at issue when determining the basis of assessment for income tax in the context of Mr Grünewald's limited tax liability. According to the referring court, Mr Grünewald could deduct business expenses or occupational expenses economically linked to income of German origin, but not special expenses such as the support payments.

13 However, the referring court considers that there is still doubt as to the compatibility of that tax regime with EU law. It is true that, in its judgment in *Schröder* (C-450/09, EU:C:2011:198), the Court held that there is a restriction of free movement of capital under Article 63 TFEU if support payments by a non-resident taxpayer connected with rental income of domestic origin arising from immovable property are not deductible, while corresponding payments undertaken by a resident person with full tax liability are deductible. However, in the view of the referring court, since the Court of Justice was not asked a question on that matter, it did not make a ruling in its judgment in *Schröder* (EU:C:2011:198) on the specific issue as to whether it is necessary to take into account the fact that the German tax regime concerned was based on the 'principle of correspondence' ('Korrespondenzprinzip'), according to which, where the person obliged to make the payment has a right to have it deducted, the recipient of the payment must be liable to tax.

14 In those circumstances, the Bundesfinanzhof decided to stay proceedings and refer the following question to the Court:

'Does Article 63 of the Treaty on the Functioning of the European Union (TFEU) preclude legislation of a Member State under which private support payments by non-resident taxable persons which are connected with a transfer of revenue-producing domestic assets in the course of an "anticipated succession" are not tax deductible, whereas such payments are deductible in the case of full liability to taxation, but the deduction results in a corresponding tax liability for a (fully taxable) recipient of the payments?'

Consideration of the question referred for a preliminary ruling

The existence of a restriction on the free movement of capital

15 It must be noted that the case that led to the judgment in *Schröder* (EU:C:2011:198) concerned the same national legislation as that whose application is the subject of the present request for a preliminary ruling. In that judgment, the Court held that Article 63 TFEU, which prohibits restrictions on capital movements, must be interpreted as precluding legislation of a Member State which, while allowing a resident taxpayer to deduct the annuities paid to a relative who transferred to him immovable property situated in the territory of that Member State from the rental income derived from that property, does not grant such a deduction to a non-resident taxpayer, in so far as the undertaking to pay those annuities results from the transfer of that property.

16 The matters of fact and law which, according to the referring court, make the present request for a preliminary ruling necessary relate to the combination of circumstances in the present case and, specifically, to the fact that (i) the income taxed in the hands of the non-resident taxpayer comes from shares in a partnership and not from the letting of immovable property and (ii) the national tax regime at issue in the main proceedings is based on the principle of correspondence, according to which the deduction of the annuity paid by the debtor must correspond to the taxation of the income derived from that annuity in the hands of the recipient.

17 In those circumstances, it must be held that, by its question, the referring court is asking, in essence, whether Article 63 TFEU is to be interpreted as precluding legislation of a Member State which does not permit a non-resident taxpayer who has received in that Member State commercial income generated by the activity of a business, the shares in which were transferred to him by a relative in the course of a gift by way of anticipated succession, to deduct from that income the annuities which he has paid to that relative in consideration for that gift, whereas that legislation allows a resident taxpayer to make such a deduction on the ground that those annuities are taxed in the hands of the recipient.

18 In that regard, it should first be observed that, in accordance with settled case-law, inheritances and gifts constitute movements of capital for the purposes of Article 63 TFEU, with the exception of cases in which their constituent elements are confined within a single Member State (see, to that effect, inter alia, judgment in *Schröder*, EU:C:2011:198, paragraph 26). Consequently, it must be held that the transfer of shares in a company established in Germany in the context of anticipated succession to a natural person residing in another Member State is covered by Article 63 TFEU.

19 Secondly, the measures prohibited by Article 63(1) TFEU as restrictions on the movement of capital include those which are liable to discourage non-residents from making investments in a Member State or from maintaining such investments (see, inter alia, judgment in *Schröder*, EU:C:2011:198, paragraph 30).

20 As regards the legislation at issue in the main proceedings, a natural person who is not domiciled or habitually resident in Germany is liable, under Paragraph 49 of the EStG, to income tax in that Member State in respect of income derived from the commercial activity conducted in Germany by a business in which that person holds shares. By contrast with resident taxpayers, pursuant to Paragraph 50 of the EStG, a non-resident taxpayer may not, as a person with limited liability for tax, only on domestic income, deduct from that income an annuity, such as that paid by Mr Grünewald in the context of the anticipated succession *inter vivos*, as special expenditure within the meaning of Paragraph 10(1)(1a) of the EStG. The less favourable tax treatment thus reserved for non-residents might deter them from accepting shares in companies established in Germany by way of anticipated succession. It might also deter German residents from naming, as beneficiaries of an anticipated succession *inter vivos*, persons resident in a Member State other than the Federal Republic of Germany (see, to that effect, judgment in *Schröder*, EU:C:2011:198, paragraph 32).

21 Such legislation therefore constitutes a restriction on the movement of capital.

22 Thirdly, it is true that, under Article 65(1)(a) TFEU, Article 63 TFEU is without prejudice to the right of Member States to distinguish, in their tax law, between taxpayers who are not in the same situation with regard to their place of residence (judgment in *Schröder*, EU:C:2011:198, paragraph 34).

23 However, it is important to distinguish unequal treatment permitted under Article 65(1)(a) TFEU from arbitrary discrimination or disguised restrictions prohibited under Article 65(3) TFEU. In order for national tax legislation such as that at issue in the main proceedings, which distinguishes between resident and non-resident taxpayers, to be regarded as compatible with the FEU Treaty provisions on

the free movement of capital, the difference in treatment must relate to situations which are not objectively comparable or must be justified by an overriding reason in the public interest (see, inter alia, judgment in *Schröder*, EU:C:2011:198, paragraph 35).

The comparability of the situations

24 It is necessary to determine whether, in circumstances such as those of the dispute before the referring court, the situation of non-residents is comparable to that of residents.

25 It is settled case-law 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 Member 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 (see, inter alia, judgment in *Schröder*, EU:C:2011:198, paragraph 37).

26 Thus, 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, given 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 (see, inter alia, judgment in *Schröder*, EU:C:2011:198, paragraph 38).

27 The position is different, however, where the non-resident receives no significant income in the State of his residence and obtains the greater part of his taxable income from an activity performed in the other Member State concerned (see, to that effect, judgment in *Schumacker*, C-279/93, EU:C:1995:31, paragraph 36).

28 Therefore, if it transpires in the present case — a point for the referring court to ascertain — that the income which Mr Grünewald earned in Germany from 1999 to 2002 constituted the greater part of his overall income during that period, his situation should be regarded as objectively comparable to that of a resident of that Member State.

29 The Court has also held, in relation to expenses directly linked to an activity which has generated taxable income in a Member State, that residents of that State and non-residents are in a comparable situation (see, inter alia, judgment in *Schröder*, EU:C:2011:198, paragraph 40 and the case-law cited).

30 Thus, expenses occasioned by the activity in question are directly linked to that activity and are accordingly necessary in order to carry out that activity (see, to that effect, judgments in *Gerritse*, C-234/01, EU:C:2003:340, paragraphs 9 and 27, and *Centro Equestre da Lezíria Grande*, C-345/04, EU:C:2007:96, paragraph 25).

31 That being so, although the income which Mr Grünewald earned in Germany in the years concerned did not constitute the greater part of his overall income, it could not be accepted that his situation was comparable with that of a resident unless the annuity which he paid were to be regarded as an expense directly linked to the income from the activity of the business established in Germany, the shares in which were transferred to him by way of anticipated succession.

32 It must be observed that it is ultimately for the national court, which has sole jurisdiction to determine the facts in the case before it and to interpret the national legislation, to determine whether that is the case. However, in preliminary ruling proceedings, the Court, which is called on to provide answers of use to the national court, may provide guidance based on the documents in the file and on the

written and oral observations submitted to it, in order to enable the national court to give judgment (see, inter alia, judgment in *Alakor Gabonatermelő és Forgalmazó*, C-191/12, EU:C:2013:315, paragraph 31 and the case-law cited).

33 In that regard, it is clear from all the evidence adduced before the Court that the commitment to pay the annuity at issue in the main proceedings stems directly from the transfer of the shares in the fruit and vegetable business, which gave rise to the income taxed in Germany, and that commitment, described by the referring court as the consideration for the transfer by way of anticipated succession, was a necessary condition for that transfer. If that was indeed the case, Mr Grünewald's situation should be regarded as comparable to that of a resident taxpayer.

34 It does not appear that that assessment may be called into question by considerations set out to that end in the order for reference or in the observations presented by the German Government before the Court.

35 First, the existence of the link between the expenses borne by the non-resident taxpayer and his taxable income in the Member State concerned cannot be dependent on the nature of the income generated by the assets thus transferred. Although the income in the case that led to the judgment in *Schröder* (EU:C:2011:198) came from letting immovable property transferred by way of anticipated succession, while the income concerned in the present case comes from shares in a fruit and vegetable business, and although, as a consequence, that income comes under different categories of taxation, the end result is not that the link between the expenditure and the income at issue in the main proceedings has to be characterised differently, since the nature of that income is of no relevance in that respect.

36 Secondly, even assuming that the amount of an annuity, such as that paid by Mr Grünewald, is determined on the basis of the debtor's ability to pay and the recipient's personal needs, the fact remains that the existence of a direct link within the meaning of the case-law cited in paragraph 29 above results, not from a correlation, of whatever kind, between the amount of the expenditure in question and that of the taxable income, but from the fact that that expenditure is inextricably linked to the activity which gives rise to that income (see, to that effect, judgment in *Schröder* EU:C:2011:198, paragraph 43).

37 Thirdly, it is common ground in the present case, as in the case that led to the judgment in *Schröder* (EU:C:2011:198), that the payment of the annuity by the non-resident taxpayer was made in the context, not of a transfer for valuable consideration of an asset but a transfer by way of anticipated succession, free of charge. In that regard, the fact that that transfer was not for valuable consideration, moreover, renders ineffective *ab initio* the argument referred to by the national court to the effect that the annuity should not be deductible in the case of the acquisition of an asset for valuable consideration unless divided into acquisition costs and an interest portion. In any event, that argument concerns the amount of the deduction and not the principle of deduction, which is the only matter at issue in the present case.

38 In those circumstances, national legislation which, in relation to income tax, does not permit non-residents to deduct an annuity paid in circumstances such as those of the case before the referring court, but which by contrast does allow residents to make that deduction, even though the situation of the non-residents and the residents is comparable, infringes Article 63 TFEU if that refusal is not justified by overriding reasons in the general interest.

The existence of overriding reasons in the general interest

39 First, it is necessary to ascertain, as the referring court requests, whether the difference in treatment at issue in the main proceedings may be justified by the need to preserve the balanced allocation of powers of taxation between the Member States, as the German Government claims.

40 It should be recalled in that regard that preservation of the balanced allocation of powers of taxation between Member States is a legitimate objective recognised by the Court. Moreover, it is settled case-law that, in the absence of any unifying or harmonising measures adopted by the European Union, the Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation (judgment in *DMC*, C-164/12, EU:C:2014:20, paragraphs 46 and 47).

41 However, in circumstances such as those of the case before the referring court, that justification does not appear to be established.

42 First of all, it must be held that, although, in accordance with the 'principle of correspondence' (Korrespondenzprinzip), mentioned in paragraph 13 above, the tax legislation of the Member State concerned precludes a non-resident debtor from deducting the annuities paid, since the income derived from those annuities for the recipient could not be taxed in the hands of that recipient, in particular because he is not himself a resident, that argument — raised by the referring court and by the German Government — appears, as the Advocate General observed in point 69 of his Opinion, in any event to be hypothetical and does not relate in any way to the circumstances of the case before the referring court.

43 Next, the fact that the annuities may not be deducted by a non-resident debtor where he has limited liability for income tax stems from Paragraph 50 of the EStG, regardless of the creditor's place of residence and whether or not those annuities are taxed in the hands of the creditor.

44 There is no basis, therefore, for considering that the aim of the legislation at issue in the main proceedings is to maintain the balanced allocation, between the Member States, of powers to impose taxes.

45 Secondly, the German Government also relies on the 'principle of correspondence' (Korrespondenzprinzip) in order to argue that the refusal to deduct the annuities paid by a non-resident who has limited liability for income tax is prompted by the need to safeguard the coherence of the national tax regime.

46 That argument cannot succeed.

47 Since no direct link has been established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy, the legislation at issue cannot be justified by the need to preserve the coherence of the national tax regime.

48 It is true that the Court has recognised that the need to maintain the coherence of a tax system can justify a restriction on the exercise of the freedoms of movement guaranteed by the Treaty. However, for an argument based on such a justification to be accepted, the Court requires a direct link to be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy, with the direct nature of that link falling to be examined in the light of the objective pursued by the rules in question (see, to that effect, judgments in *Papillon*, C-418/07, EU:C:2008:659, paragraphs 43 and 44, and *Commission* v *Germany*, C-211/13, EU:C:2014:2148, paragraph 55).

49 There is no such direct link when it is a question, in particular, of different taxes or the tax treatment of different taxpayers (judgment in *DI. VI. Finanziaria di Diego della Valle & C.*, C-380/11, EU:C:2012:552, paragraph 47). That is the position in the present case, since the deduction of the annuities by the debtor and the taxation of those annuities in the hands of the recipient necessarily concerns different taxpayers.

50 The German Government argues, however, that if the deduction of the private support payments were authorised in Germany without those payments being taxed at the same time in the hands of the recipients, a double advantage would accrue to the entire group, made up of the parents and their descendants, within which an anticipated succession takes place ('Generationennachfolgeverbund') and which must, according to the German Government, be treated as a 'quasi' single tax entity since a transfer of the ability to pay tax takes place within that group.

51 However, in addition to the fact that the non-taxation of the annuities in the hands of the recipients does not fit with the circumstances of the case before the referring court, as was stated in paragraph 42 above, it is common ground that in all cases, pursuant to Paragraph 50 of the EStG, non-resident taxpayers are not permitted to deduct support payments, whether or not those payments are taxed in Germany. Accordingly, the non-resident taxpayer is treated as such by the national legislation, and not as a member of the single tax entity referred to in the preceding paragraph, since that legislation makes no provision for the deduction of payments that that taxpayer has made if those payments are taxed in the hands of the recipient.

52 Lastly, in relying without further explanation on the risk of the payments being deducted a second time in the recipient's State of residence, the German Government does not enable the Court to assess the implications of that argument when it has not been claimed that that risk could not have been avoided through the application of Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums (OJ 1977 L 336, p. 15), in force at the time.

53 Consequently, the German Government cannot rely on its argument concerning the preservation of the tax regime applicable to the single tax entity, in order to justify the discriminatory treatment of the non-resident taxpayer.

54 In the light of all the foregoing considerations, the answer to the question referred is that Article 63 TFEU must be interpreted as precluding legislation of a Member State which does not permit a non-resident taxpayer who has received in that Member State commercial income generated by shares in a business which were transferred to him by a relative in the course of a gift by way of anticipated succession to deduct from that income the annuities which he has paid to that relative in consideration for that gift, whereas that legislation allows a resident taxpayer to make such a deduction.

Costs

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

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

Article 63 TFEU must be interpreted as precluding legislation of a Member State which does not permit a non-resident taxpayer who has received in that Member State commercial income generated by shares in a business which were transferred to him by a relative in the course of a gift by way of anticipated succession to deduct from that income the annuities which he has paid to that relative in consideration for that gift, whereas that legislation allows a resident taxpayer to make such a deduction.

[Signatures]