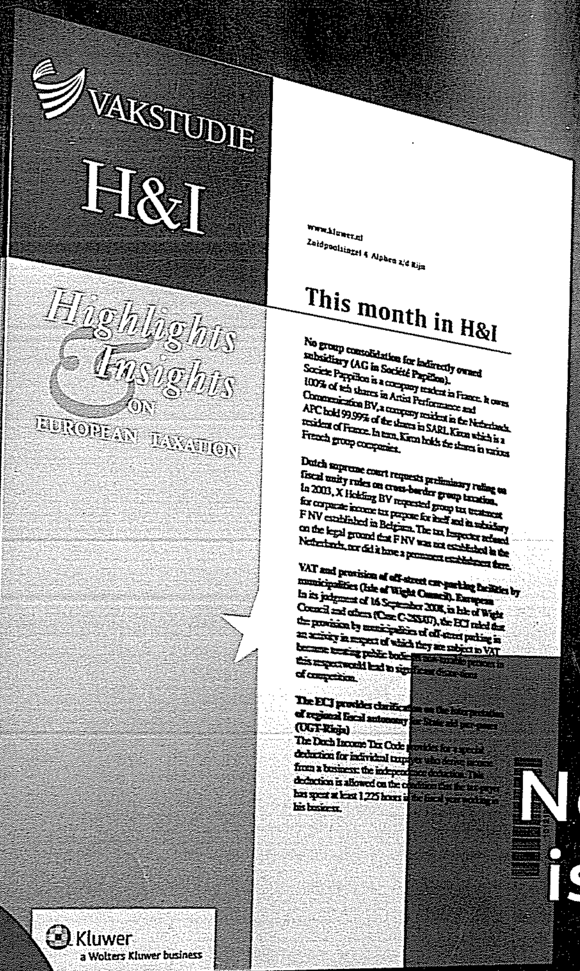
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European Commission refers Spain and Portugal to ECJ regarding exit tax provisions on companies which cease to be tax resident in these countries. European Commission (comments by Barba and Silva)

Commission v Spain. Taxation of capital gains. Difference in treatment of residents and non-residents (comments by Dourado)

Marks and Spencer plc. Relief for losses of a non-UK resident subsidiary simply requires quantification of those losses on a UK basis and elimination of amounts which fail the ECJ's 'no possibilities' test. UK First-tier Tribunal (Tax) (comments by Shiers)

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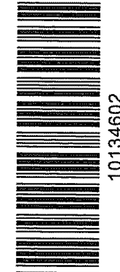

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The ECJ again stresses the importance of legal certainty. See para. 22: 'In that connection, attention should be drawn to the importance, both for the Community legal order and for the national legal systems, of the principle of res judicata. In order to ensure stability of the law and legal relations, as well as the sound administration of justice, it is important that judicial decisions which have become definitive after all rights of appeal have been exhausted or after expiry of the time-limits provided for in that regard can no longer be called into question (Case C-224/01 Köbler [2003] ECR I-10239, paragraph 38, and Case C-234/04 Kapferer [2006] ECR I-2585, paragraph 20).' But, as decided in former cases (see above), the principle of *res judicata* is not untouchable: 'In the absence of Community legislation in this area, the rules implementing the principle of res judicata are a matter for the national legal order, in accordance with the principle of the procedural autonomy of the Member States. However, those rules must not be less favourable than those governing similar domestic actions (principle of equivalence); nor may they be framed in such a way as to make it in practice impossible or excessively difficult to exercise the rights conferred by Community law (principle of effectiveness) (see, to that effect, Kapferer, paragraph 22).'

After these general remarks, the ECJ answered the question as to whether the Italian application of the principle of *res judicata* in this case was in line with the principle of effectiveness or not. This is somewhat curious in my opinion. The principle of effectiveness relates to the rights which individuals derive from Community law. Compare, for example, the recent conclusion of AG Trstenjak in the *Asturcom* case (ECJ 6 October 2009, C-40/08) (underscored by author): 'By laying down the procedural rules for proceedings designed to ensure protection of the rights which individuals acquire through the direct effect of Community law, Member States must ensure that such rules are not less favourable than those governing similar domestic actions (principle of equivalence) and are not framed in such a way as to render impossible in practice the exercise of rights conferred by Community law (principle of effectiveness).' But this case does not relate to rights of individuals but to duties of individuals. The individual at hand has to pay the correct amount of VAT, in line with the respective EC directives. As a consequence of the principle of *res judicata* as interpreted and applied by the Italian courts, the primacy of Community law is being obstructed. Thus, in my opinion, the principle of effectiveness is not the appropriate principle to check whether an exception could be accepted to the principle of *res judicata*. I would have expected the ECJ to have based its decision on the principle of the primacy of Community law rather than the principle of effectiveness, as it did in the *Lucchini* case. The ECJ does not make clear why it invokes the principle of effectiveness. Furthermore, it is not clear what the reason is for differentiating between this case and the *Lucchini* case, as regards the grounds of the respective decisions.

As regards the application of the principle of effectiveness, the ECJ is very clear: '30 Accordingly, if the principle of res judicata were to be applied in that manner, the effect would be that, if ever the judicial decision that had become final were based on an interpretation of the Community rules concerning abusive practice in the field of VAT which was at odds with Community law, those rules would continue to be misapplied for each new tax year, without it being possible to rectify the interpretation. 31 In those circumstances, it must be held that such extensive obstacles to the effective application of the Community rules on VAT cannot reasonably be regarded as justified in the interests of legal certainty and must therefore be considered to be contrary to the principle of effectiveness.' The ECJ is of the opinion that the Italian interpretation and application of the principle of *res judicata* is not in line with Community law. The Italian approach would mean that once a false decision has been taken, a court would never be able to repair this. This contravenes the effective application of Community rules in respect of VAT. The principle of legal certainty does not justify the Italian interpretation of the principle of *res judicata*.

Reading the decision of the ECJ, I get the feeling that the ECJ basis its decision finally on the primacy of Community law, since the ECJ speaks about the effective application of Community rules. So it remains unclear on which principle (principle of effectiveness or principle of principle of primacy of Community law) the decision of the ECJ is based.

Arjo van Eijsden

DIRECT TAXATION, LEGISLATION

4 Taxation of mergers, divisions, partial divisions – codified version. Council of the European Union

The Council has adopted a Directive on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States (12818/09). The new Directive is aimed at codifying Directive 90/434. The new legislative act supersedes the various acts incorporated in it, while fully preserving the content of the act being codified.

Council of the European Union, 01 October 2009, no. 12818/09

The full text can be found on the internet site of Highlights & Insights at www.kluwer.nl/hi under Archives.

DIRECT TAXATION, CASE LAW

5 Commission v Spain. Taxation of capital gains. Difference in treatment of residents and non-residents. ECJ (comments by Dourado)

The European Court of Justice has given a judgment in the case Commission v Spain. The Court declares that, by treating differently, until 31 December 2006, capital gains realised in Spain according to whether they were made by residents or by non-residents, the Kingdom of Spain failed to fulfil its obligations under Article 56 EC and Article 40 of the Agreement on the European Economic Area of 2 May 1992.

European Court of Justice, 06 October 2009, no. C-562/07

Judgment of the Court (First Chamber)

6 October 2009

(Failure of a Member State to fulfil obligations – Free movement of capital – Article 56 EC and Article 40 of the EEA Agreement – Direct taxation – Natural persons – Taxation of capital gains – Difference in treatment of residents and non-residents)

In Case C-562/07, ACTION under Article 226 EC for failure to fulfil obligations, brought on 19 December 2007,

Commission of the European Communities, represented by R. Lyal and I. Martínez del Peral, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Kingdom of Spain, represented by M. Muñoz Pérez, acting as Agent, with an address for service in Luxembourg,

defendant,

supported by:

Kingdom of Belgium, represented by T. Materne, acting as Agent,

Republic of Latvia, represented by E. Balode-Buraka, acting as Agent,

Republic of Austria, represented by E. Riedl and C. Pesendorfer, acting as Agents,

interveners,

THE COURT (First Chamber), composed of M. Ilešič, President of the Fifth Chamber and acting President of the First Chamber, A. Tizzano, A. Borg Barthet, E. Levits and J.-J. Kasel (Rapporteur), Judges,

Advocate General: J. Kokott,
Registrar: R. Grass,
having regard to the written procedure,
having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,
gives the following

***Judgment*[1]**

1 By its application, the Commission of the European Communities asks the Court to declare that, by having treated differently, until 31 December 2006, capital gains realised in Spain according to whether they were made by residents or by non-residents, the Kingdom of Spain failed to fulfil its obligations under Articles 39 EC and 56 EC and Articles 28 and 40 of the Agreement on the European Economic Area of 2 May 1992 (OJ 1994, L 1, p. 3, 'the EEA Agreement').

Legal context

2 In Spain, the taxation of residents' income was, until 31 December 2006, governed by the consolidated law on the tax on the income of natural persons (Texto Refundido de la Ley del Impuesto sobre la Renta de las Personas Físicas), adopted by Royal Legislative Decree No 3/2004 of 5 March 2004 (BOE No 60 of 10 March 2004, p. 10670, and corrigendum, BOE No 61 of 11 March 2004, p. 11014, 'the TRLIRPF'). Pursuant to Articles 67 and 77 of the TRLIRPF, capital gains accruing on the disposal by the taxpayer of assets owned for more than one year were taxed at a flat rate of 15%. Other capital gains were taxed according to a progressive scale laid down in Articles 64 and 75 of the TRLIRPF, the rates of which ranged from 15% to 45%.

3 Until the same date, the taxation of non-residents' income was governed by the consolidated law on the tax on the income of non-residents (Texto Refundido de la Ley del Impuesto sobre la Renta de no Residentes), adopted by Royal Legislative Decree No 5/2004 of 5 March 2004 (BOE No (62 of 12 March 2004, p. 11176, 'the TRLIRNR'), Article 25(1)(f) of which subjected capital gains to a flat rate of tax of 35%.

4 Under Article 46 of the TRLIRNR, non-residents at least 75% of whose total income came, in a single tax year, from employment or economic activity in Spain, were able to choose to be taxed as persons liable to the tax on the income of natural persons. Article 46(3) provided that the personal and family circumstances of those workers were to be taken into consideration.

5 That system was repealed as from 1 January 2007 with the entry into force of Law No 35/2006 on the taxation of income of natural persons and partially amending the laws on corporation tax, taxation on the income of non-residents and taxation on wealth (Ley 35/2006 del Impuesto sobre la Renta de las Personas Físicas y de modificación parcial de las leyes de los Impuestos sobre Sociedades, sobre la Renta de no Residentes y sobre el Patrimonio, BOE No 285 of 29 November 2006, p. 41734, and corrigendum, BOE No 57 of 7 March 2007, p. 9634).

The pre-litigation procedure

6 On 18 October 2004 the Commission sent a letter of formal notice to the Kingdom of Spain, drawing the attention of that Member State to the fact that the way in which natural persons who were not resident in Spain were treated as regards the taxation to which their employment income and their capital gains arising in Spain were at that time subject was, in the Commission's opinion, contrary to Article 39 EC and 56 EC and to Articles 28 and 40 of the EEA Agreement, since the application to non-residents' income of taxation at a higher rate than that applicable to residents' income could constitute discrimination for the purpose of the EC Treaty if there was no objective difference capable of justifying a difference in treatment of the two situations.

7 Since the reply of the Kingdom of Spain did not satisfy the Commission, on 13 July 2005 the Commission sent a reasoned opinion to that Member State, calling upon it to adopt the measures necessary to achieve compliance within two months of receipt.

8 On 7 February 2006, the Kingdom of Spain replied to that reasoned opinion stating that the amendments necessary to put an end to the alleged failures to fulfil obligations were being adopted. It appears from the observations of the parties that those amendments were adopted on 28 November 2006 and entered into force on 1 January 2007.

1 Language of the case: Spanish.

9 Although the Commission considers that, with the entry into force of the new provisions, the infringements which it complained of were bought to an end, the Commission decided to bring the present action.

10 In the course of the proceedings before the Court, the Commission withdrew its action in so far as seeking a declaration of an infringement of Article 39 EC and Article 28 of the EEA Agreement.

11 By order of the President of the Court of 2 June 2008, the Kingdom of Belgium, the Republic of Latvia and the Republic of Austria were given leave to intervene in support of the forms of order sought by the Kingdom of Spain.

The action

Admissibility

Arguments of the parties

12 The Kingdom of Spain, which acknowledges that it is for the Commission to decide whether or not it is appropriate to initiate an action for failure to fulfil obligations, nonetheless calls into question the admissibility of this action, claiming that the Commission has, in the present case, infringed the principles of the protection of legitimate expectations, cooperation in good faith with Member States and legal certainty, and has misused its powers.

13 As regards, first, the infringement of the principles of the protection of legitimate expectations and cooperation in good faith, the Kingdom of Spain states that Member States may rely on those principles against a Community institution where that institution, by a repeated and uninterrupted practice, has caused them to have a justified expectation that the institution would follow a specific line of conduct in specific circumstances, and there is nothing to suggest that the institution will alter that practice. In relation to infringement proceedings, the Commission has a well-established practice which consists of not initiating such an action where the Member State which has infringed Community law has put an end to the failure after the expiry of the period prescribed in the reasoned opinion, but before the bringing of the action, even when the proceedings may still be relevant.

In the present case, the Commission infringed the abovementioned principles because it brought its action almost a year after the failure complained of had been brought to an end, and did not either first inform the Member State concerned of its intention to depart from its usual practice or have any valid grounds for doing so.

14 As regards, secondly, the principle of legal certainty, the Kingdom of Spain claims that the right which the Commission is acknowledged to have freely to choose when to initiate infringement proceedings against a Member State should, in order not to put Member States into a 'serious situation of legal uncertainty', be restricted to cases where the offending Member State persists in the failure complained of. Since the Commission, in the present case, allowed almost a year to elapse from the time when the alleged failure was brought to an end and the bringing of this action, the principle of legal certainty has been infringed.

15 As regards, thirdly, misuse of powers, the Kingdom of Spain claims that the Commission is distorting the purpose of infringement proceedings since it is using such proceedings to achieve two objectives which are extraneous to that purpose. First, the Commission's intention is to punish the Kingdom of Spain because the Spanish courts and tribunals have not submitted references for a preliminary ruling to the Court of Justice on the subject of direct taxation. Secondly, the Commission wants to obtain a ruling from the Court on this action in order to ensure that citizens have the benefit of correctly applied Community law, and thereby assimilates the purpose of infringement proceedings to that of the preliminary rulings procedure.

16 The Kingdom of Belgium and the Republic of Austria, whose interventions in support of the forms of order sought by the Kingdom of Spain are limited to the question of the action's admissibility, claim that it is the task of the Commission to establish the existence of sufficient interest to continue proceedings. In the present case, the seriousness of the alleged failure is not such as to justify the bringing of an action, since the fact that the Spanish courts and tribunals have not

submitted references for a preliminary ruling on the subject of direct taxation does not demonstrate sufficient interest to bring the present action. Furthermore, the Commission can bring infringement proceedings only with the specific aim of putting an end to the alleged failure to fulfil obligations. Since the Kingdom of Spain has put an end to the failure complained of, the Commission is no longer to free to assess whether it is appropriate to bring an action.

17 As regards the admissibility of infringement proceedings in general, the Commission contends, principally, that the discretion which the Treaty and the Court's case-law accord to it in relation to infringement proceedings means, first, that it can decide whether or not it is appropriate to bring an action and that it does not have to state the reasons for its decision and, secondly, that it is not bound to comply with any specific time-limit as regards the various stages of proceedings. Therefore, in its opinion, none of the grounds of inadmissibility put forward by the Kingdom of Spain can succeed.

Findings of the Court

18 As regards, first, the alleged infringement of the principle of protection of legitimate expectations, a corollary of the principle of legal certainty, and the principle of cooperation in good faith, it must be recalled that the procedure for a declaration of failure on the part of a Member State to fulfil its obligations is based on the objective finding that a Member State has failed to fulfil its obligations under Community law and that the principles of protection of legitimate expectations and loyal cooperation cannot, in circumstances such as those of the present case, be relied on by a Member State in order to preclude an objective finding of a failure on its part to fulfil its obligations under the EC Treaty, since to admit that justification would run counter to the aim pursued by the procedure under Article 226 EC (Case C-523/04 *Commission* v *Netherlands* [2007] ECR I-3267, paragraph 28).

19 The fact that the Commission may, where appropriate, have decided not to bring an action seeking a declaration that a Member State has failed to fulfil obligations where that Member State had put an end to the alleged failure after the expiry of the time prescribed in the reasoned opinion cannot therefore cause either that Member State or other Member States to have a legitimate expectation which may affect the admissibility of an action brought by the Commission.

20 Nor, it must be added, can the fact that the Commission does not bring an action under Article 226 EC immediately after the expiry of the time prescribed in the reasoned opinion cause the Member State concerned to have a legitimate expectation that the infringement proceedings have been closed.

21 Admittedly, the excessive duration of the pre-litigation procedure is capable of constituting a defect rendering an action for failure to fulfil obligations inadmissible. However, it is clear from the case-law that such a conclusion is inevitable only where the conduct of the Commission has made it difficult to refute its arguments, thus infringing the rights of defence of the Member State concerned, and that it is for that Member State to provide evidence of such a difficulty (see, to that effect, Case C-33/04 *Commission* v *Luxembourg* [2005] ECR I-10629, paragraph 76 and case-law there cited).

22 It is however clear that, in the present case, the Kingdom of Spain has not put forward any specific argument in support of the fact that the length of the pre-litigation procedure and, in particular, the period of time which elapsed between its response to the reasoned opinion and the bringing of this action, affected the exercise of its rights of defence. The Kingdom of Spain does no more than dispute the appropriateness, in the present case, of the Commission exercising its right to initiate and continue infringement proceedings.

23 As regards, secondly, the principle of legal certainty, it must be pointed out that the Court has consistently held that, first, the question whether there has been a failure to fulfil obligations must be examined on the basis of the position in which the Member State found itself at the end of the period laid down in the reasoned opinion (see, inter alia, Case C-173/01 *Commission* v *Greece* [2002] ECR I-6129, paragraph 7, and Case C-519/03 *Commission* v *Luxembourg* [2005] ECR I-3067, paragraph 18) and, secondly, the Commission still has an interest in bringing an action under Article 226 EC even when the alleged infringement has been remedied after the expiry of the period prescribed in the reasoned opinion (Case C-519/03 *Commission* v *Luxembourg*, paragraph 19).

24 It follows that, since the Kingdom of Spain was informed through the pre-litigation procedure

that the Commission alleged that it had failed to fulfil its obligations under the Treaty, it cannot, in the absence of any explicit statement of position by the Commission indicating that it was going to close the ongoing infringement proceedings, validly contend that the Commission has infringed the principle of legal certainty.

25 As regards, thirdly, the plea in law based on an alleged misuse of powers, suffice it to state that, in accordance with the Court's settled case-law, the Commission does not have to show an interest to bring proceedings or to state the reasons why it is bringing an action for failure to fulfil obligations (see, inter alia, Case C-333/99 *Commission* v *France* [2001] ECR I-1025, paragraph 24; Case C-474/99 *Commission* v *Spain* [2002] ECR I-5293, paragraph 25; and Case C-33/04 *Commission* v *Luxembourg*, paragraphs 65 and 66). Since the subject-matter of the action as it is to be found in the application corresponds to the subject-matter of the dispute as stated in the letter of formal notice and in the reasoned opinion, it cannot validly be maintained that the Commission has misused its powers.

26 It follows from the foregoing considerations that the present action must be declared admissible.

Substance

Arguments of the parties

27 The Commission states that, under the Spanish legislation applicable until 31 December 2006, capital gains realised in Spain by non resident taxpayers upon a disposal of assets were taxed at a flat rate of 35%, whereas those realised by residents were taxed according to a progressive scale where the assets disposed of had been owned for one year or less and at a flat rate of 15% where those assets had been owned for more than one year. Consequently, the tax liability borne by non-residents was always greater when they disposed of their assets one year or more after the acquisition of those assets. As regards the disposal of an asset owned for one year or less, non-residents were again subject to a higher tax liability, except when the average tax rate applied to resident taxpayers reached or exceeded 35%, which was the case when income was very substantial.

28 According to the Commission, since, in the present case, there is no objective difference between resident taxpayers and non-resident taxpayers, any difference in treatment manifesting itself in a higher tax liability for non-residents as compared with residents constitutes discrimination for the purposes of the Treaty.

29 As regards the justifications put forward by the Kingdom of Spain, the Commission claims that, in the present case, pursuit of an objective of tax cohesion cannot validly be relied upon. In accordance with the Court's case-law, that justification can be accepted only when there is a direct link between the granting of a tax advantage and the offsetting of that advantage by a fiscal charge. In the present case, the higher tax liability borne by non-residents was not accompanied by their enjoyment of any tax advantage.

30 The Commission adds that it considers that the reasoning adopted by the Court in Case C-107/94 *Asscher* [1996] ECR I-3089 can be applied to the present case, since the Spanish tax provisions at issue in the present action, like the provisions of national law at issue in *Asscher*, provide for the application to capital gains realised by non-residents of taxation at a higher rate than that applicable to capital gains made by residents. Having regard to the Court's case-law, the fact that *Asscher* relates to freedom of establishment does not preclude the outcome of that case being applied to the Spanish provisions at issue in the present case.

31 The Kingdom of Spain, which does not accept that there was the failure alleged, states, first, that the capital gain which a non-resident realises upon selling an asset which he owns in Spain constitutes only a part of his income, the latter generally consisting mainly of income derived from his occupation. In addition, in order to determine whether resident taxpayers and non-resident taxpayers are in an objectively comparable situation, it is necessary to take an overall view of the activities of those taxpayers and the income which they derive from them, and not to examine only one single type of transaction.

32 The place where the individual ability of a non-resident to pay tax can most easily be assessed is the place where his personal and property interests are centred. As a general rule, that coincides with the place where he is habitually resident. Where there are exceptions, the Kingdom

of Spain states that taxpayers who do not reside in Spain, but who have obtained there, from their employment and their other economic activities, income constituting at least 75% of their total income, may, under the system provided for in Article 46 of the TRLIRNR, and for as long as it is established that they have their domicile or habitual residence in another Member State, choose to have their income taxed according to the rules applicable to residents. The Spanish legislation thus complies with the Court's case-law, the Kingdom of Spain referring in that regard to Case C-234/01 *Gerritse* [2003] ECR I-5933.

33 In any event, since the situation of resident taxpayers and non-resident taxpayers is not comparable in relation to the taxation of capital gains, the fact that there is not one identical body of rules which applies to both those categories of taxpayers does not constitute discrimination. Consequently, in the present case, there is no failure to observe the principle of free movement of capital.

34 Next, the Kingdom of Spain states that, in accordance with the Court's case-law, a Member State is free to ensure compliance with its obligations under the Treaty by entering into an agreement to prevent double taxation (a 'double taxation agreement') with another Member State. Since the Kingdom of Spain has entered into a double taxation agreement with almost all Member States, Spanish taxation, the effects of which are in part eliminated, therefore does not constitute a restriction on free movement of capital.

35 Lastly, the Kingdom of Spain states that in paragraph 43 of Case C-376/03 *D.* [2005] ECR I-5821 the Court held that Articles 56 EC and 58 EC do not preclude national legislation which denies non-resident taxpayers who hold the major part of their wealth in the State where they are resident entitlement to allowances which that legislation grants to resident taxpayers. The Spanish tax legislation at issue in the present case does no more than apply that case-law by introducing, into the tax system, a distinction based on the objectively different situation in which resident taxpayers are placed as compared with non-resident taxpayers.

36 Alternatively, in the event that the legislation at issue is deemed to constitute a restriction on the free movement of capital, the Kingdom of Spain claims that that restriction was justified by the need to safeguard the cohesion of the Spanish tax system.

37 In that regard, the Kingdom of Spain states that, as regards short-term capital gains (one year or less), those realised by non-residents were taxed on a transaction-by-transaction basis, while those realised by residents were taxed according to the progressive scale applicable to income tax, the rates of which ranged from 15% to 45%. It cannot therefore be held that residents were systematically afforded a tax treatment which was more favourable that that afforded to non-residents.

38 In any event, the existence of distinct rates for the tax on residents and the tax on non-residents is justified by the very nature of each of those taxes. The tax on the income of natural persons who are resident is levied periodically and adjusted to the person concerned's ability to pay by means of applying a progressive scale to the worldwide income received by that person during the taxation period.

39 The tax on the income of non-residents is, on the other hand, a tax which is immediately payable by taxpayers who receive income in Spain and have no permanent establishment there. Those taxpayers are taxed only on income which they receive in Spain, income which is, by definition, one-off and sporadic. It is therefore impossible to tax that income according to a progressive scale. The only way of achieving the taxation of that income is to levy a tax on a transaction-by-transaction basis by the application of a flat rate.

40 Under the legislation applicable to natural persons who are resident, capital gains made over the long term (more than one year) were taxed at rates the same as or lower than those at which short-term capital gains (one year or less) were taxed. The objective pursued was to avoid the cumulative effects of a progressive scale on capital gains generated over a number of years, which, rather than being subject to annual taxation as they arise, are taxed when they are realised. There was therefore a direct economic link between the granting of a tax advantage to resident taxpayers – taxation at a reduced rate – and the harm which they would suffer in the absence of that mechanism to eliminate excessive progressivity, or another mechanism with the same effects. However, there is no reason to apply to non-resident taxpayers a more favourable taxation rate in the event that they realise long-term capital gains. In fact, through the application of a flat rate of 15 %, they have received a favourable treatment intended to offset the effects of a progressive scale which is not applicable to them.

Findings of the Court

41 First, it must be recalled that Article 56 EC prohibits restrictions on the movement of capital, subject to the provisions of Article 58 EC. It is clear from Article 58(1) and (3) EC that Member States may, in their tax law, distinguish between resident and non-resident taxpayers in so far as the distinction drawn does not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital.

42 It must be added that Article 58(1) EC, which, as a derogation from the fundamental principle of the free movement of capital, must be interpreted strictly, cannot be interpreted as meaning that any tax legislation making a distinction between taxpayers by reference to the place where they invest their capital is automatically compatible with the Treaty (see, to that effect, Case C-315/02 *Lenz* [2004] ECR I-7063, paragraph 26).

43 In the present case, it is common ground that until 31 December 2006 the Spanish legislation provided for a difference in treatment of resident taxpayers and non-resident taxpayers as regards the rate of taxation to which were subject capital gains accruing on the disposal of assets, either fixed assets or other kinds of assets, owned in Spain.

44 As regards capital gains realised further to the disposal of assets owned for more than one year, non-residents were systematically subject to a higher tax liability than that borne by residents, the capital gains realised by the latter being taxed at the flat rate of 15% while those realised by non-residents were taxed at 35%.

45 Admittedly, because of the application to them of the progressive scale, residents were not systematically entitled to a more favourable taxation rate than non-residents in relation to the taxation of capital gains realised upon the sale of assets owned for one year or less. Nevertheless, given that non-residents were subject to a flat rate of 35% irrespective of the amount of the capital gain realised, whereas residents were subject to that rate only when their overall income reached a certain threshold, non-residents were subject, at least in some circumstances, to a tax liability greater than that borne by residents.

46 As the Court has already held, in relation to direct taxes, the situations of residents and of non-residents within a State 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 is habitually resident (Case C-279/93 *Schumacker* [1995] ECR I-225, paragraphs 31 and 32, and *Gerritse*, paragraph 43).

47 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 having regard to the objective differences between the situations of residents and of non-residents, from the point of view both of the source of their income and of their personal ability to pay tax or their personal and family circumstances (*Schumacker*, paragraph 34, and *Gerritse*, paragraph 44).

48 In the present case, it is therefore necessary to examine whether there is an objective difference between the situation of residents and that of non-residents which may allow the discriminatory character of the legislation at issue to be disregarded and may bring that legislation within the exception provided for in Article 58(1) EC.

49 As regards the argument that the difference in tax treatment resulting from the application of that legislation to non-residents must be examined together with the general income tax system applicable to residents and non-residents, and that non-residents cannot be compared to residents, because they have in their State of residence other income which, unlike that of residents, is not taken into account in Spain, it must be observed that, first, at least in respect of the taxation of capital gains accruing on the disposal of assets owned for more than one year, only that type of gain is targeted by the legislation in question, whether the taxpayers are resident or non-resident.

50 Secondly, the State in which the source of the income is situated is in both cases the Kingdom of Spain, since the legislation at issue targets only capital gains accruing on the disposal of assets owned in Spain.

51 As regards the argument that, in relation to capital gains accruing on the disposal of assets owned for more than one year, the purpose of the legislation at issue is to take account of the personal situation of the taxpayer in respect of payment of the tax, suffice it to state that the

legislation contains nothing capable of supporting that argument, since it concerns taxation levied at a flat rate which is solely dependent on the status of the taxpayer as resident or non-resident.

52 Nor can that argument be supported by an application of *Gerritse* by way of analogy, as relied on by the Kingdom of Spain. It has neither been demonstrated nor even claimed that the legislation against which the present action is directed, as distinct from that at issue in *Gerritse*, pursued, by means of granting an advantageous tax treatment to residents, a social purpose. It follows that, in contrast to what the Court decided in paragraph 48 of *Gerritse*, it cannot, in the present case, be regarded as legitimate to reserve the grant of that advantageous treatment to persons who receive the greater part of their taxable income in the State of taxation, that is to say, as a general rule, residents.

53 As regards the double taxation agreements on which the Kingdom of Spain relies, it must be observed, first, that the Kingdom of Spain has not claimed to have entered into any double taxation agreement with the States which are parties to the EEA Agreement. Next, as the Kingdom of Spain itself acknowledges, a double taxation agreement has not been entered into with all other Member States. Lastly, it is common ground that the double taxation agreements that are in place cancel out only in part the tax liability of non-residents in Spain.

54 It is clear moreover from the Court's case-law that the existence of a double taxation agreement does not mean that the income which a taxpayer receives in a State where he is not resident and which is exclusively liable to tax in that State may not nevertheless be taken into consideration by the State of residence when calculating the amount of the tax on the remaining income of that taxpayer in order, in particular, to reflect the principle that taxes should be applied progressively. It cannot therefore be validly argued that the fact that a taxpayer is non-resident enables him to escape the application of that rule. It follows that, in such circumstances, the two categories of taxpayers are in a comparable situation with regard to that rule (see, to that effect, *Asscher*, paragraphs 47 and 48).

55 In those circumstances, it must be concluded that, in relation to the taxation of capital gains accruing on the disposal of assets owned for more than one year, the legislation at issue does not correspond to any difference in situation, for the purposes of Article 58(1) EC, based on the taxpayers' place of residence (see, to that effect, *Lenz*, paragraph 33).

56 The same conclusion must be drawn as regards the taxation of capital gains realised after no more than one year.

57 First, the considerations adopted in paragraphs 58 and 60 to 62 of this judgment apply equally to taxation of that kind.

58 Secondly, while the possibility cannot be ruled out that taxation according to a progressive scale is capable of taking account of taxpayers' ability to pay, the Kingdom of Spain has not advanced any evidence sufficient to establish that, in the present case, account is actually taken of the personal situation of resident taxpayers in relation to the taxation of capital gains accruing on the disposal of assets owned for one year or less.

59 It follows that the Kingdom of Spain's argument, both in respect of short-term and long-term capital gains, that, with regard to the taxation at issue, residents and non-residents are not in an objectively comparable situation, is unfounded and therefore cannot be accepted.

60 It remains however to be considered whether, as claimed in the alternative by the Kingdom of Spain, that difference in treatment of those two categories of taxpayers may be justified by an overriding reason in the public interest, such as the need to safeguard the cohesion of the tax system.

61 In that regard, it is clear from the case-law of the Court that such an objective may justify a restriction on the exercise of the fundamental freedoms guaranteed by the Treaty. However, for an argument based on such a justification to succeed, a direct link has to be established between the granting of the tax advantage concerned and the offsetting of that advantage by a particular tax levy (Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 42).

62 According to the Kingdom of Spain, the tax legislation at issue seeks to avoid penalising residents, in the context of the taxation of capital gains, by applying a progressive scale. As regards the taxation of capital gains accruing on the disposal of assets owned for more than one year, there is a direct link, for residents, between the tax advantage resulting from the taxation of those capital gains at the flat rate of 15% and the progressive tax scale applicable to their total income. As regards capital gains realised in one year or less, the advantage of not being subject to a flat rate

of 35% is offset by residents being subject to taxation according to a progressive scale on the whole of their worldwide income.

63 As regards the first of those situations, it must be observed that the income to which the flat rate of 15% is applied is not subject to income tax according to a progressive scale. Therefore, it cannot validly be claimed the granting to residents of the tax advantage at issue, namely the taxation of that income at a flat rate of 15%, is offset by the application of a progressive scale in respect of the taxation of income.

64 As regards the second situation, the advantage, for the resident taxpayer, of not being subject to a flat rate of 35% is admittedly, as a general rule, offset by the disadvantage of having the capital gains concerned added to his total income and thereby subject to taxation according to a progressive scale. However, the possibility cannot be ruled out that, even when taxed in that way, the capital gains realised by residents may be less heavily taxed than those realised by non-residents.

65 In those circumstances, it must be concluded that there is no direct link between the advantages granted to resident taxpayers and any offsetting as a result of a particular tax levy.

66 Consequently, the Court must reject the Kingdom of Spain's argument that the restriction stemming from the legislation at issue is justified by the need to safeguard the cohesion of the national tax system.

67 Since the provisions of Article 40 of the EEA agreement have the same legal scope as the provisions, identical in substance, of Article 56 EC (see Case C-521/07 *Commission* v *Netherlands* [2009] ECR I-0000, paragraph 33), the foregoing considerations can be applied *mutatismutandis* to Article 40.

68 Having regard to all of the foregoing considerations, the action brought by the Commission must be considered well founded.

69 In those circumstances, it must be declared that, by treating differently, until 31 December 2006, capital gains realised in Spain according to whether they were made by residents or by non-residents, the Kingdom of Spain failed to fulfil its obligations under Article 56 EC and Article 40 of the EEA Agreement.

Costs

70 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Kingdom of Spain has been unsuccessful and the Commission has applied for costs, the Kingdom of Spain must be ordered to pay the costs.

On those grounds, the Court (First Chamber) hereby

1. Declares that, by treating differently, until 31 December 2006, capital gains realised in Spain according to whether they were made by residents or by non-residents, the Kingdom of Spain failed to fulfil its obligations under Article 56 EC and Article 40 of the Agreement on the European Economic Area of 2 May 1992;
2. Orders the Kingdom of Spain to pay the costs.

[Signatures]

Comment

The Spanish tax legislation under analysis provided until 31 December 2006 for a difference of tax rates applicable to capital gains accruing on the disposal by the individual taxpayer of assets, depending on whether the individual was a resident or a non-resident in Spain, for tax purposes. Non-resident individuals with at least 75% of their total income from employment or economic activity in Spain were able to choose to be taxed as tax residents. Resident taxpayers were taxed at a flat rate of 15% in case they disposed of assets owned in Spain for more than one year, and to progressive rates ranging between 15% and 45% regarding assets disposed before that date, and non-resident taxpayers were always subject to a flat withholding tax of 35%.

There are two situations relevant for the possible discriminatory assessment. One concerns the application of different flat rates to residents and non-residents, where the rate applicable to non-residents is always higher. The second one concerns application of a 35% flat rate to

non-residents whereas in some cases, residents may be subject either to a lower or to a higher tax rate, since they range between 15% and 45%.

In its case law regarding potential discriminatory taxation of non-resident individuals based on different treatment of the latter in comparison to residents, the Court has drawn a line between objective differences regarding taxation of residents and non-residents which would not amount to a discriminatory treatment, and the non-existence of those objective differences. In the first group of situations, the comparability test fails, and therefore there is no base for a discrimination assessment, whereas the second group implies comparison, and consequently, different treatment means discriminatory treatment.

The existence of objective differences has been the point of departure on the analysis by the Court following the *Schumacker* line of reasoning concerning taxation of individuals (*Schumacker* ECJ 14 February 1995, C-279/93, paras. 31-32; *Wielockx*, ECJ 11 August 1995, C-80/94, para. 18; *Asscher* ECJ 27 June 1996, C-107/94, para. 41, *Gschwind* ECJ 14 September 1999, C-391/97, para. 22, *Zurstrassen* ECJ 16 May 2000, C-87/99, para. 21, *Gerritse* ECJ 12 June 2003, C-234/01, para. 43, *Talotta* ECJ 22 March 2007, C-383/05, para. 19; *Renneberg* ECJ 16 October 2008, C-527/06, para. 59), and has recently been applied in *Truck Center* (ECJ 22 December 2008, C-282/07, paras. 38-39) to taxation of non-resident corporations.

However in contrast, according to the internal market or the overall approach followed in *ICI* (ECJ 16 July 1998, C-264/96) and *Marks & Spencer* (ECJ 13 December 2005, C-446/03), foreign nationals and companies are to be treated in the host Member State in the same way as nationals of that State and the Member State of origin is prohibited from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (this approach is applicable to any other freedom, e.g., free movement of capital (*cf. Manninen* ECJ 7 September 2004, C-319/02, para. 23). This approach means that residents and non-residents are, in principle, in a comparable position and any discrimination or restriction to the internal market has to be justified.

According to the former line of reasoning (i.e., in *Schumacker* and the subsequent ones), individual residents and non-residents are not as a rule in a comparable position, because the income received in the territory of a Member State by a non-resident is normally only a part of his total income, and therefore there is limited tax liability in the source State, whereas the State of residence is the centre of his personal and financial interests. It is in the State of residence that he receives most of his income and therefore, is taxed according to his ability-to-pay: he is then taxed on his aggregate income, his personal and family circumstances are taken into account (e.g. by way of tax allowances) and he is subject to progressive rates.

The arguments put forward by Spain, in the subject *Commission v. Spain* case, were based on this non-comparability between residents and non-residents. However, as mentioned above, a difference in treatment between residents and non-residents, namely, in the case of a tax advantage not available to a non-resident, may constitute discrimination within the meaning of the Treaty where there is no objective difference between the situations of the two (*Talotta*, para. 19; *Renneberg*, para. 60). It is then necessary to ask whether in the *Commission v. Spain* case, there is or there is not a comparable situation between residents and non-residents.

The main relevant issue in the *Commission v. Spain* case concerns a difference founded on residence regarding tax rates, which are higher when applied to non-resident taxpayers than to resident ones, or may be higher than those applicable to resident taxpayers or to those treated as such. Contrary to the aforementioned general statement, according to which resident and non-resident taxpayers are not in a comparable position, in respect of tax rates and progressivity, the Court has taken a different position: it has taken an internal market or overall approach, since it considered in *Asscher* and *Gerritse*, for example, that both residents and non-residents are subject to progressivity – the latter in their State of residence – and flat taxes in the host Member State will be taken into account for progressivity purposes in the State of residence. Consequently, when tax rates are under analysis, there is no objective difference between residents and non-residents and they are in a comparable situation, so that application to the former of a higher rate of income tax constitutes discrimination, unless it is justified. For example, again in *Asscher* and *Gerritse*, comparability existed because both residents and non-residents were subject to progressivity in their States of residence and taxed income at source would be taken into account for the purpose of that progressivity (*Gerritse*, paras. 52 - 54).

In summary, in respect of taxation of individuals, the Court generally combines an approach based on the non-comparability between residents and non-residents, in respect of the tax base, unless there is no objective difference between the situations of the two, with an approach based on the comparability when tax rates come into play. This reasoning was partially followed in *Truck Center*, where the Court considered there was no comparability between companies receiving income from capital (interest) consisting of the application of different taxation arrangements or different charges based on separate legal bases (para. 43) – final withholding tax on gross income paid by a resident company to a recipient company resident in another Member State v. exemption of that retention where interest was paid to a recipient company resident in the first Member State and included in the taxable base – i.e. taxed as net income. According to the Court in *Truck Center*, companies are not in a comparable situation where a State either acts in its capacity as the State of residence of the companies concerned or as the State in which the income originates (para. 42). This statement seems to go further than the *Schumacker* line of reasoning, since, as previously recalled, this reasoning was based on ability-to-pay considerations, whereas in *Truck Center* different tax arrangements and different ability to ensuring compulsory recovery of taxes seem sufficient to justify different treatment of residents and non-residents (paras. 41, 47, 48). But finally another main argument put forward by the Court in *Truck Center* goes in the same direction as *Schumacker* and subsequent case law, based on it (including the *Commission v. Spain* case): I refer to the amount of the tax or the tax rates: 'the amount of withholding tax deducted from the interest paid to a non-resident company is significantly lower than the corporation tax charged on the income of resident companies which receive interest' (*Truck Center*, para. 49). Even if the reasoning in *Truck Center* can be criticized and even if the Court was possibly too fast in its conclusion in the its paragraph 49, the same type of arguments concerning tax rates can again be found in the *Commission v. Spain* case.

In *Commission v. Spain*, in the case resident taxpayers disposed of assets owned in Spain for more than one year, both the tax base and the tax rates are comparable to taxation of non-residents, since in both cases, there is flat rate taxation on assets, either fixed or other kinds of assets, located in Spain. In other words, tax only targets source income and therefore, there is no objective difference between the situations of residents and non-residents and in both cases, tax rates are only applicable to capital gains (and not aggregate income) which result from disposal of assets owned in Spain (*cf.* paras. 43, 49 and 50). It is not surprising, therefore, that the Court considered that non-residents were being systematically discriminated, since the rate was always objectively higher – 35% instead of 15%.

But also in respect of resident taxpayers subject to progressive rates ranging between 15% and 45% concerning assets disposed before one year, non-residents can be compared to residents, since in relation to the taxation of accruing capital gains, there is no sufficient evidence demonstrating that account is taken of the personal and familiar circumstances of resident taxpayers. Thus, non-residents and residents are in an objectively comparable situation and in some cases, non-resident taxpayers could be discriminated, since they were always subject to a flat withholding tax of 35%, whereas residents were only subject to that or higher rates if their aggregate income reached a certain threshold (see para. 45). In short, the different tax treatment of residents and non-residents was not based on ability-to-pay considerations, but essentially on tax rates and these were objectively higher when applicable to non-residents.

The facts of the *Commission v. Spain* case differ in several relevant aspects from the *Commission v. Portugal* case (ECJ, 26 October 2006, C-345/05. See, Ana Paula Dourado/Ricardo Reigada Pereira, 'Portuguese recent and pending cases', *ECJ, Recent Developments in Direct Taxation 2007*, Michael Lang, Josef Schuch, Claus Staringer (eds.), Linde Verlag, Wien, 2007, pp. 185 - 201). Let me recall that the Portuguese regime analyzed under the mentioned case concerned an entitlement to exemption from capital gains tax, arising on the transfer for valuable consideration of real property intended for the taxable person's own and permanent residence or for that of a member of his family. Such exemption was subject to the condition that the gains realized should be reinvested in the purchase of real property situated in Portuguese territory. This provision was considered to restrict the free movement of workers and the freedom of

establishment. In all events, the Portuguese regime introduced a discriminatory exemption and not discriminatory tax rates, and it supposedly had a social purpose connected to taxation of residents (the constitutional right to accommodation). It however restricted free movement, since exemption of new real property intended for the taxable person's own and permanent residence was only granted if that property was situated within the Portuguese territory and if that social purpose were relevant, it should be extended to property situated in the territory of another Member State. Thus, both the Portuguese and the Spanish capital gains tax regimes, although substantially different, discriminated non-residents and neither of them was justified by a legitimate objective in the public interest.

Ana Paula Dourado

6 Commission v. Federal Republic of Germany. Discrimination in limitation of savings-pension provisions to residents. ECJ (comments by Richter)

Infringement proceedings against the Federal Republic of Germany. Benefits for complementary pension schemes limited to residents of Germany.

Court: Germany has failed to fulfil its obligations under Art. 39 of the EC Treaty and Article 7 (2) of Regulation (EEC) No 1612/68 and Article 18 EC insofar as its provisions for complementary pensions

– deny cross-border workers and their spouses the right to a savings-pension bonus, unless they are fully liable to tax in Germany

– prohibit cross-border workers from using the subsidised capital for the acquisition or construction of an owner-occupied dwelling unless that property is situated in Germany, and

– provide that the bonus be reimbursed on termination of full liability to tax in Germany

European Court of Justice, 10 September 2009, no. C-269/07

Judgment of the Court (Second Chamber) 10 September 2009

(Failure of a Member State to fulfil obligations – Freedom of movement for workers – Regulation (EEC) No 1612/68 – Savings-pension bonus – Full liability to tax)

In Case C-269/07, ACTION under Article 226 EC for failure to fulfil obligations, brought on 6 June 2007,

Commission of the European Communities, represented by R. Lyal and W. Mölls, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Federal Republic of Germany, represented by C. Blaschke and M. Lumma, acting as Agents, assisted by D. Wellisch, Rechtsanwalt, with an address for service in Luxembourg, defendant,

THE COURT (Second Chamber), composed of C. W. A. Timmermans, President of Chamber, K. Schiemann, J. Makarczyk, L. Bay Larsen (Rapporteur) and C. Toader, Judges,

Advocate General: J. Mazák,

Registrar: R. Şereş, Administrator,

having regard to the written procedure and further to the hearing on 17 December 2008,

after hearing the Opinion of the Advocate General at the sitting on 31 March 2009

gives the following

Judgment[1]

1 By its application, the Commission of the European Communities seeks a declaration from the Court that, by introducing and maintaining the provisions for complementary pensions in Paragraphs 79 to 99 of the Federal Law on Income Tax (Einkommensteuergesetz; 'the EStG'), the

1 Language of the case: German.

Federal Republic of Germany has failed to fulfil its obligations under Article 39 EC and Article 7 of Regulation (EEC) No 1612/68 of the Council of 15 October 1968 on freedom of movement for workers within the Community (OJ, English Special Edition 1968 (II), p. 475) and under Articles 12 EC and 18 EC, in so far as those provisions:

– deny cross-border workers (and their spouses) the right to a bonus, unless they are fully liable to tax in that Member State;

– do not permit the subsidised capital to be used for an owner-occupied dwelling, unless that dwelling is in Germany, and

– require the repayment of the subsidy on termination of full liability to tax.

Legal context

Community legislation

2 Article 7(1) and (2) of Regulation No 1612/68 provides:

'1. A worker who is a national of a Member State may not, in the territory of another Member State, be treated differently from national workers by reason of his nationality in respect of any conditions of employment and work, in particular as regards remuneration, dismissal, and should he become unemployed, reinstatement or re-employment.

2. He shall enjoy the same social and tax advantages as national workers.'

National legislation

3 Paragraph 1 of the EStG is worded as follows:

'(1) Natural persons having their domicile or habitual residence in Germany shall be fully liable to income tax. ...

...

(3) At their request, natural persons having neither their domicile nor habitual residence in Germany may also be fully liable to income tax in so far as they receive income arising in Germany within the meaning of Paragraph 49. This option applies only if at least 90% of their income during a calendar year is subject to German income tax or if their income not subject to German income tax does not exceed EUR 6136 a calendar year. ...

...'

4 Paragraph 10a(1) of the EStG provides that persons insured under the statutory pension insurance scheme may deduct annually as special expenses, up to a certain threshold, their savings-pension contributions together with the savings-pension bonus granted pursuant to Paragraph 79 et seq. Paragraph 10(a)(1) of the EStG also provides that, in addition to persons insured under the statutory pension insurance scheme, other categories of persons are to benefit from those deduction rules. Paragraph 10(a)(2) of the EStG sets out the relationship between the deduction as special expenses of savings-pension contributions and the grant of the bonus referred to in Paragraph 79 of the EStG and provides that the regime which is more advantageous for the taxpayer must be applied.

5 Paragraph 79 of the EStG, entitled 'Beneficiaries of the bonus', provides:

'Taxpayers who are fully liable to income tax and are beneficiaries pursuant to Paragraph 10a(1) are entitled to a savings-pension bonus (bonus). In the case of married couples who fulfil the conditions under Paragraph 26(1) and where only one spouse is a beneficiary under the first sentence, the other spouse may also obtain the bonus if there is a savings-pension contract in their name.'

6 According to Paragraph 83 of the EStG, entitled 'Savings-pension bonus', a bonus which consists of a basic bonus and a supplement for children is granted in accordance with contributions made to the savings-pension.

7 Paragraph 84 of the EStG states the amount of the basic bonus which each beneficiary may claim.

8 Paragraph 85 of the EStG states the additional amount which the beneficiary of the basic bonus may claim for children in respect of which he receives family allowances.

9 According to Paragraph 92a of the EStG, entitled 'Use for an owner-occupied dwelling':

'(1) The beneficiary of the bonus may use directly at least EUR 10.000 of the capital built up under a savings-pension contract and subsidised under Paragraph 10a or of this section for the