JUDGMENT OF THE COURT

14 September 1999 *

In Case C-391/97,

REFERENCE to the Court under Article 177 of the EC Treaty (now Article 234 EC) by the Finanzgericht Köln, Germany, for a preliminary ruling in the proceedings pending before that court between

Frans Gschwind

and

Finanzamt Aachen-Außenstadt,

on the interpretation of Article 48 of the EC Treaty (now, after amendment, Article 39 EC),

THE COURT,

composed of: G.C. Rodríguez Iglesias, President, P.J.G. Kapteyn, G. Hirsch and P. Jann (Presidents of Chambers), C. Gulmann, J.L. Murray, D.A.O. Ed-

* Language of the case: German.

ward, H. Ragnemalm, L. Sevón, M. Wathelet (Rapporteur) and R. Schintgen, Judges,

Advocate General: D. Ruiz-Jarabo Colomer,

Registrar: D. Louterman-Hubeau, Principal Administrator,

after considering the written observations submitted on behalf of:

— Frans Gschwind, by W. Kaefer, Tax Adviser, Aachen,

— the Finanzamt Aachen-Außenstadt, by J. Viehöfer, Regierungsdirektor at the Finanzamt Aachen-Außenstadt,

— the German Government, by E. Röder, Ministerialrat at the Federal Ministry for the Economy, and C.-D. Quassowski, Regierungsdirektor at the same ministry, acting as Agents,

— the Belgian Government, by J. Devadder, Director of Administration in the Legal Service of the Ministry of Foreign Affairs, External Trade and Development Cooperation, acting as Agent,

— the Commission of the European Communities, by H. Michard, of its Legal Service, assisted by A. Buschmann, a national civil servant on secondment to the Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Frans Gschwind, represented by W. Kaefer, assisted by G. Saß; of the Finanzamt Aachen-Außenstadt, represented by E. Marx, Leitender Regierungsdirektor at the Finanzamt Aachen-Außenstadt; of the German Government, represented by C.-D. Quassowski; of the Netherlands Government, represented by J. S. van den Oosterkamp, Deputy Legal Adviser at the Ministry of Foreign Affairs, acting as Agent; and of the Commission, represented by A. Buschmann, at the hearing on 26 January 1999,

after hearing the Opinion of the Advocate General at the sitting on 11 March 1999,

gives the following

Judgment

1 By order of 27 October 1997, received at the Court on 17 November 1997, the Finanzgericht (Finance Court), Cologne, referred to the Court for a preliminary ruling under Article 177 of the EC Treaty (now Article 234 EC) a question on the interpretation of Article 48 of the EC Treaty (now, after amendment, Article 39 EC).

2 The question has been raised in proceedings between Frans Gschwind and the Finanzamt Aachen-Außenstadt (hereinafter 'the Finance Office') concerning the conditions for the assessment to tax of income from employment arising in Germany.

The relevant national law

3 German income tax legislation has different tax rules depending on the taxable person's place of residence. Under Paragraph 1(1) of the Einkommensteuergesetz (Law on Income Tax, hereinafter 'the EStG'), natural persons who have their permanent residence or usual abode in Germany are subject there to tax on their total income ('unlimited taxation'). However, under Paragraph 1(4), natural persons not having their permanent residence or usual abode in Germany are subject to tax only on the part of their income arising in Germany ('limited taxation'). Under Paragraph 49(1)(4) of the EStG, such income of German origin includes income from gainful employment in Germany.

4 For married, not permanently separated, taxpayers subject to unlimited taxation, the German legislature has introduced joint assessment arrangements, involving the setting of a joint tariff combined with a splitting procedure to mitigate the progressive nature of the income tax scale. According to Paragraph 26b of the EStG, 'the income earned by the spouses shall be aggregated and attributed to them jointly, and the spouses shall thenceforward be treated as one taxpayer, save where provision is made to the contrary'. Under Paragraph 32a(5) of the EStG, income tax for jointly assessed spouses is to be 'twice the amount of tax arising in respect of half of their jointly taxable income... (splitting procedure)'. The income is therefore charged to tax as if each spouse had each earned one half. This means that, where there is a significant difference between the income of the two spouses, the couple receives tax relief. Owing to the combined effect of the splitting procedure and the progressive nature of German taxation, the greater the disparity between the spouses' respective income the greater, as a rule, is the tax relief.

5 This favourable tax treatment was originally restricted to spouses who resided in Germany, even where one of them earned income abroad, that income being taken into account for the calculation of the rate of tax under the progressive scale.

6 Since the legislative amendment passed in 1995 in order to adapt the income tax system for non-residents to the law as declared by the Court of Justice in its judgment of 14 February 1995 in Case C-279/93 *Schumacker* [1995] ECR I-225 and of 11 August 1995 in Case C-80/94 *Wielockx* [1995] ECR I-2493, a married taxable person who has neither permanent residence nor usual abode in Germany and who is a national of one of the Member States of the European Communities or of one of the Contracting Parties to the Agreement on the European Economic Area may now, under Paragraph 1a(1), point 2, of the EStG, apply for joint assessment under the splitting procedure, where that person's spouse resides in one of those States and

— the total income of the spouses is subject, as to at least 90%, to German income tax

— or their income not so subject does not exceed DEM 24 000 in the calendar year.

7 In those circumstances, although the spouses have neither permanent residence nor usual abode in Germany, German law treats them as being subject to unlimited taxation. As such, they are entitled to the other tax concessions accorded to residents to take account of their personal and family circumstances (family expenses, welfare expenses and other outgoings which in general give rise to tax reliefs and rebates).

8 Under Paragraphs 26 and 26a of the EStG, those taxpayers may, by applying for separate taxation, avoid the additional charge to tax which would arise from splitting owing to the progressive scale (for example, where a spouse receives a large amount of income from abroad).

The main proceedings

9 Mr Gschwind, a Netherlands national, lives with his wife in the Netherlands, close to the German border. In 1991 and 1992, he was gainfully employed in Aachen in Germany whilst his wife was employed in the Netherlands.

10 During each of those years Mr Gschwind had taxable earnings of DEM 74 000, representing nearly 58% of the household's aggregated income. In accordance with Article 10(1) of the Convention between the Federal Republic of Germany and the Kingdom of the Netherlands for the prevention of double taxation in the matter of income tax, property tax and other taxes and regulating other tax questions, signed at The Hague on 16 June 1959 (hereinafter 'the Convention'), Mr Gschwind's income was taxable in Germany whilst his spouse's income was taxable in the Netherlands. However, under Article 20(3) of the Convention, the Netherlands tax authorities were entitled to include in the tax base income taxable in Germany whilst deducting from the tax so calculated the part of it corresponding to the taxable income in Germany.

11 Following the amendment of the tax legislation in 1995, applicable to taxes not yet paid on the date on which it came into force, the German tax authorities, in

1997, assessed Mr Gschwind to income tax, for 1991 and 1992, as a person subject to unlimited taxation but treated him as if he were single, on the ground that, under Paragraph 1(3) and Paragraph 1a(1), point 2, of the EStG, the income received by his wife in the Netherlands exceeded both the absolute non-impact threshold of DEM 24 000 a year and the relative threshold of 10% of the household's aggregated income. That assessment entailed for Mr Gschwind an additional tax charge of DEM 1 012 for 1991 and DEM 724 for 1992 compared with the tax which he would have paid under the scale applicable to married couples, as provided for in Paragraphs 26 and 26b of the EStG, under the splitting procedure.

12 After his objection to the assessments to tax for the years 1991 and 1992 had been dismissed, Mr Gschwind appealed to the Finanzgericht Köln before which he argued that the refusal to apply the scale arrived at under the splitting procedure to married Community citizens working in Germany and residing in another Member State was contrary to Article 48 of the Treaty and to the judgments of the Court of Justice in *Schumacker*, cited above, and Case C-107/94 *Asscher* [1996] ECR I-3089.

13 In order to resolve the case, the Finanzgericht Köln decided to stay proceedings and to refer the following question to the Court for a preliminary ruling:

'Is it contrary to Article 48 of the EC Treaty for Paragraph 1(3), second sentence, in conjunction with Paragraph 1a.1.2 of the Einkomensteuergesetz (German Law on Income Tax) to provide that a Netherlands national deriving taxable income from employment in Germany without having a permanent residence or usual abode there and his spouse, who is not permanently separated from him and likewise has no permanent residence or usual abode in Germany and earns income abroad, are not to be treated as persons subject to unlimited taxation for the purposes of applying Paragraph 26(1), first sentence, of the Einkommensteuergesetz (joint assessment) on the ground that the combined income of the

spouses for the calendar year in question does not fall as to at least 90% within the Einkommensteuergesetz, or that the income not subject to the Einkommensteuergesetz amounts to more than DEM 24 000?'

14 By its question the national court asks essentially whether Article 48(2) of the Treaty precludes the application of a Member State's legislation which grants resident married couples favourable tax treatment, such as that under the splitting procedure, yet makes the same treatment of non-resident married couples subject to the condition that at least 90% of their total income must be subject to tax in that Member State or, if that percentage is not reached, that their income from foreign sources not subject to tax in that State must not be above a certain ceiling.

15 According to the Finanzamt and the German and Netherlands Governments, the different treatment of residents and non-residents in relation to the application of the splitting procedure is not contrary to Community law. In making the grant of this concession to non-residents subject to the condition that the spouses' total income must be subject to German income tax as to at least 90% or that their income not subject to German income tax must not exceed DEM 24 000, the German legislature has drawn the appropriate inferences from the judgment in the *Schumacker* case. In their view, that judgment required non-residents to be allowed the benefit of the splitting procedure only if their personal and family circumstances could not be taken into account in the State of their residence owing to the fact that they gained their main income and almost all their family income in Germany.

16 They contend that, in a case such as this, in which a significant part of the family revenue is gained in the State of residence of the taxpayer, that State is in a

position to grant the taxpayer the concessions, provided for in its legislation, which arise from having his personal and family circumstances taken into account.

17 The Belgian Government, on the other hand, contends that there is no objective reason to justify refusing to apply the splitting procedure to a non-resident couple on the ground that the couple's income from foreign sources exceeds a specific ceiling or a given percentage of the couple's total income. The German splitting arrangement does not have the purpose or the effect of conferring a tax advantage linked to a taxpayer's personal or family circumstances, which might be granted a second time in the State of residence. It is more a method of determining the tax rate, based on the overall ability to pay of the economic entity which the couple forms.

18 Finally, the Commission submits that, since the State of residence, which in this case is the Kingdom of the Netherlands, has waived taxation of the plaintiff's earned income under a double-taxation treaty, only the State of his employment is in a position to take into consideration the plaintiff's personal and family circumstances. Besides, a taxpayer will opt for splitting only in the State in which the spouse who earns the most income is taxed because that is the only way that splitting would enable the amount of tax to be reduced by mitigating the progressivity of the tax scale. Splitting could not therefore lead to double tax relief due to the taxpayer's family circumstances in both the State of residence and the State of employment. Furthermore, the situation in question is objectively comparable to that of a couple residing in Germany one of whom receives, in another Member State, earned income exempt from German tax under a double-taxation treaty but to whom the German legislature allows the splitting arrangement to be applied.

19 Nor does the Commission accept that, under the judgment in *Schumacker*, cited above, the German legislature could properly make provision for account to be taken of both spouses' income to ensure that the income thresholds are observed.

Since German tax is charged only on the income of the plaintiff to which the spouse's income is added solely in order to take account of tax progressivity and not in order to tax that income as well, the Commission is doubtful whether it is consistent to take account of both spouses' income in order to assess whether the 90% threshold is reached.

20 The Court observes first of all that, although direct taxation falls within the competence of the Member States, the latter must none the less exercise that competence consistently with Community law and therefore avoid any overt or covert discrimination by reason of nationality (*Schumacker*, paragraphs 21 and 26, and *Wielockx*, paragraph 16, both cited above).

21 It is settled law that discrimination arises through the application of different rules to comparable situations or the application of the same rule to different situations.

22 As far as direct taxes are concerned, the situations of residents and of non-residents in a given State are not generally comparable, since income received in the territory of a State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence, and a non-resident's personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is more easy 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 (*Schumacker*, cited above, paragraphs 31 and 32).

23 In paragraph 34 of *Schumacker*, cited above, the Court held that the fact that a Member State does not grant to a non-resident certain tax benefits which it grants to a resident is not, as a rule, discriminatory having regard to the objective

differences between the situations of residents and of non-residents, both from the point of view of the source of their income and their personal ability to pay tax or their personal and family circumstances.

24 Moreover, for tax purposes residence is the connecting factor on which international tax law, in particular the Model Double-Taxation Convention of the Organisation for Economic Cooperation and Development (OECD), is normally founded in order to allocate powers of taxation between States in situations involving extraneous elements.

25 Thus, in the case of a married couple residing in the Netherlands one of whom works in Germany, whilst that latter State is, under Article 10(1) of the Convention, solely competent to tax income earned in its territory, the Kingdom of the Netherlands, as the State of residence, may, under Article 20(3) of the Convention, include in the tax base income taxable in Germany whilst deducting from the tax so calculated the part of it corresponding to income taxable in Germany. Conversely, under Article 20(2) of the Convention, if the State of residence is the Federal Republic of Germany, that State, whilst excluding from the tax base income taxable in the Netherlands, calculates the amount of tax on income taxable in Germany at the rate applicable to the taxpayer's total income.

26 In those circumstances, there could be discrimination within the meaning of the Treaty between residents and non-residents only if, notwithstanding their residence in different Member States, it was established that, having regard to the purpose and content of the national provisions in question, the two categories of taxpayers are in a comparable situation.

27 According to the case-law of the Court, this is the case where the non-resident has no significant income in the State of his residence and gains the main part of his

taxable income from an activity in the State of employment. In those circumstances, his State of residence is not in a position to grant him the benefits resulting from the taking into account of his personal and family circumstances, so that there is no objective difference between the situation of such a non-resident and that of a resident engaged in comparable employment such as to justify different treatment as regards the taking into account for taxation purposes of the taxpayer's personal and family circumstances (*Schumacker*, cited above, paragraphs 36 and 37).

28 A situation such as that in question in the main proceedings is, however, clearly different from that with which the judgment in *Schumacker* was concerned. Mr Schumacker's income formed almost the entire income of his tax household and neither he nor his spouse had any significant income in their State of residence allowing account to be taken of their personal and family circumstances. However, by laying down a percentage threshold and an absolute threshold for income respectively taxable in Germany and not subject to German tax, the German legislation takes account specifically of the possibility of taking into consideration, on a sufficient tax base, of the personal and family circumstances of taxpayers in the State of residence.

29 In the present case, given that nearly 42% of the total income of the Gschwinds is received in their State of residence, that State is in a position to take into account Mr Gschwind's personal and family circumstances according to the rules laid down by the legislation of that State, since the tax base is sufficient there to enable them to be taken into account.

30 Consequently, it is not established that, for the application of tax provisions such as those in question in the main proceedings, a non-resident married couple of whom one spouse works in the State of taxation in question and who may, owing to the existence of a sufficient tax base in the State of residence, have his personal

and family circumstances taken into account by the tax authorities of that latter State is in a situation comparable to that of a resident married couple, even if one of the spouses works in another Member State.

31 As regards the Commission's argument that, for the purposes of determining the income thresholds, it is not consistent to take account of the two spouses' income since the splitting method is applied only to the non-resident taxpayer's income, it must be stated that, although the person subject to the tax of the State of employment is the individual and not the couple, a method of calculating the rate of taxation such as the splitting method is based by its nature on the practice of taking account of the income of each of the spouses.

32 It follows from the foregoing that Article 48(2) of the Treaty is to be interpreted as not precluding the application of a Member State's legislation under which resident married couples are granted favourable tax treatment such as that under the splitting procedure whilst the same treatment of non-resident married couples is made subject to the condition that at least 90% of their total income must be subject to tax in that Member State or, if that percentage is not reached, that their income from foreign sources not subject to tax in that State must not be above a certain ceiling, thus maintaining the possibility for account to be taken of their personal and family circumstances in the State of residence.

Costs

33 The costs incurred by the German, Belgian and Netherlands Governments and by the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT,

in answer to the question referred to it by the Finanzgericht Köln by order of 27 October 1997, hereby rules:

Article 48(2) of the EC Treaty (now, after amendment, Article 39(2) EC) is to be interpreted as not precluding the application of a Member State's legislation under which resident married couples are granted favourable tax treatment such as that under the splitting procedure whilst the same treatment of non-resident married couples is made subject to the condition that at least 90% of their total income must be subject to tax in that Member State or, if that percentage is not reached, that their income from foreign sources not subject to tax in that State must not be above a certain ceiling, thus maintaining the possibility for account to be taken of their personal and family circumstances in the State of residence.

Rodríguez Iglesias Kapteyn Hirsch

Jann Gulmann

Murray Edward Ragnemalm

Sevón Wathelet Schintgen

Delivered in open court in Luxembourg on 14 September 1999.

R. Grass

Registrar

G.C. Rodríguez Iglesias

President