JUDGMENT OF THE COURT (Fourth Chamber)

15 September 2011 *

In Case C-240/10,

REFERENCE for a preliminary ruling under Article 267 TFEU from the Finanzgericht Baden-Württemberg (Germany), made by decision of 21 December 2009, received at the Court on 14 May 2010, in the proceedings

Cathy Schulz-Delzers,

Pascal Schulz

v

Finanzamt Stuttgart III,

THE COURT (Fourth Chamber),

composed of J.-C. Bonichot, President of the Chamber, K. Schiemann (Rapporteur), C. Toader, A. Prechal and E. Jarašiūnas, Judges,

* Language of the case: German.

Advocate General: P. Mengozzi,
Registrar: B. Fülöp, Administrator,

having regard to the written procedure and further to the hearing on 24 March 2011,

after considering the observations submitted on behalf of:

— Ms Schulz-Delzers and Mr Schulz, by S. Hoffmann, Rechtsanwalt,

— the German Government, by T. Henze and C. Blaschke, acting as Agents,

— the Spanish Government, by M. Muñoz Pérez, acting as Agent,

— the European Commission, by R. Lyal and W. Mölls, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 26 May 2011,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 12 EC, 18 EC and 39 EC.

2 The reference has been made in proceedings between Ms Schulz-Delzers and Mr Schulz (referred to hereafter together as 'the Schulz spouses'), on the one hand, and the Finanzamt Stuttgart III ('the Finanzamt'), on the other hand, concerning the income tax assessment notice issued by the Finanzamt for the years 2005 and 2006.

Legal context

Taxation of income in Germany

3 The taxation of income was governed in Germany, in the years 2005 and 2006, by the Law on income tax (Einkommensteuergesetz; 'EStG'), in the version applicable during those years.

4 Under Paragraph 1 of the EStG, inter alia natural persons who are domiciled or habitually resident in Germany are subject to unlimited income tax liability.

5 The rate of income tax is fixed according to a progressive scale, the tax rate increasing in accordance with the level of income. That scale reflects an assessment of the taxpayer's ability to pay tax carried out by the legislature on the basis of living conditions in Germany.

6 Some types of revenue are exempt from income tax. In that regard, a distinction is inter alia made between income which, while not itself subject to tax, is taken into account in calculating the tax rate applicable to other income applying the progressive tax scale, and that which is not taken into account for that purpose. The first-mentioned income is classified as exempt income 'subject to its being taken into account in the progressive application of the tax' ('Progressionsvorbehalt').

7 Taking into account, in the progressive application of the tax, certain income exempted when determining the tax rate applicable to other income, reflects an assessment of the taxpayer's ability to pay tax carried out by the legislature. The taxpayer who receives income which is exempt but taken into account in the progressive application of the tax can, according to the legislature, afford to pay more tax than a taxpayer without such income. Consequently, certain replacement income is taken into account in that regard which is in principle exempt such as, for example, unemployment benefit. Such benefits are intended not to compensate for certain costs but to guarantee generally sufficient means of subsistence for the recipients.

8 By contrast, if the legislature provided for an exemption not coupled with the taking into account of the income concerned in the progressive application of the tax, it proceeds on the basis of the principle that the exempt income may not be regarded as a factor in the ability to pay tax and must not be so regarded, even for the purposes of taxation of other income.

9 In order to mitigate the progressive application of the income tax scale in relation to spouses with different levels of income, the German legislature introduced, for taxpayers subject to unlimited tax liability, being married and not permanently separated, a system of joint tax assessment resulting in a common tax base, combined with the application of so-called 'splitting'. To that end, the income received by the spouses is aggregated and attributed to them jointly. The income tax of spouses subject to joint tax assessment amounts to double that on half of their joint taxable income.

Taxation, in Germany, of income from a French public institution

10 The Convention between the French Republic and the Federal Republic of Germany on the avoidance of double taxation and on mutual administrative and judicial assistance in the area of taxes on income and capital, trade taxes and real property taxes, signed at Paris on 21 July 1959 (*Bundesgesetzblatt* 1961 II, p. 397) as amended by the Additional Agreement signed at Paris on 20 December 2001 (*Bundesgesetzblatt* 2002 II, p. 2370) ('the Franco-German Tax Convention'), provides, in the first sentence of Article 14(1), for the 'paying State principle', according to which salaries, wages and similar remuneration which are paid by a legal person governed by public law of a Contracting State to natural persons residing in the other State in respect of present service in the administration are taxable only in the first State.

11 Article 20(1) of the Franco-German Tax Convention provides, in order to avoid double taxation, that the income originating in France which is taxable in France under that convention is to be exempt from the German tax base of residents of the Federal Republic of Germany. It is provided that that rule does not restrict the right of the Federal Republic of Germany to take into account, when determining its tax rate, the income so exempted.

12 Those provisions apply both to the basic pay of French civil servants residing in Germany and to the additional allowances they receive as a result of their expatriation in Germany.

13 Under Paragraph 32b(1)(3) of the EStG:

'Where a person who is temporarily or during the whole period of assessment subject to unlimited tax liability...

...

3. has received income which, provided it is included when the income tax is calculated..., is exempt from tax under an agreement for the avoidance of double taxation or any other international agreement, a special tax rate shall be applied to the taxable income under Paragraph 32a(1).'

14 Paragraph 32b(2)(2) of the EStG provides:

'The special tax rate under subparagraph (1) is the tax rate which arises where, on calculating the income tax, the taxable income under Paragraph 32a(1) is increased or reduced by...

...

2. in the cases referred to in subparagraph (1)(2) and (3), the income designated there, with one fifth of the extraordinary income included therein being taken into account.'

Taxation, in Germany, of the expatriation allowances granted to German taxpayers working abroad

15 Whereas the income of taxpayers working as civil servants abroad is subject to unlimited income tax liability in Germany, any possible allowances granted to them on account of their expatriation are exempt, in Germany, from income tax and are not taken into account in the progressive application of that tax.

16 Paragraph 3(64) of the EStG provides:

'The earnings of employees who are employed by a German legal person governed by public law and who, on that basis, receive a salary paid by a public body in Germany, shall be exempt from tax where those earnings are for an activity abroad and exceed the remuneration to which the employee would be entitled for an equivalent

activity at the location of the public body of payment. The first sentence also applies where the employee is employed by another person who determines the remuneration in accordance with the provisions applying for the purpose of the first sentence, the remuneration is paid by a public body and comes entirely or mainly from public funds. In the case of other employees who are posted abroad for a limited period, who are domiciled or habitually resident there, the purchasing power adjustment granted by a national employer shall be exempt from tax, provided that it does not exceed the amount allowed for comparable foreign service remuneration pursuant to Paragraph 54 of the Federal Law on remuneration of civil servants ("Bundesbesoldungsgesetz")."

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

17 The Schulz spouses reside in Germany and have two dependent children. They chose to be assessed jointly to tax on the whole of their income for the purposes of Paragraph 1 of the EStG, in order to be able to enjoy a more favourable common tax base.

18 Mr Schulz, a German national, is employed as a lawyer and received income on that basis in the years 2005 and 2006.

19 Ms Schulz-Delzers, a French national, works in Germany as a civil servant of the French State as a teacher at a Franco-German primary school. In 2005 and 2006 she received from the French State, in addition to her salary, two types of allowances which, under Article 14 in conjunction with Article 20(1) of the Franco-German tax

convention, are – like her salary – exempt in Germany, subject to their being taken into account in the progressive application of the tax.

20 The two allowances concerned are:

— an allowance linked to local living conditions, granted to civil servants of the French State working abroad on the basis of Article 4B(d) of Decree No 2002-22 of 4 January 2002 concerning the administrative and financial situation of the staff of French educational institutions abroad (JORF of 6 January 2002, p. 387), intended as an adjustment for loss of purchasing power and amounting to monthly payments of EUR 437.41 and EUR 444.08 for the years 2005 and 2006 respectively, and

— a 'family allowance' granted in respect of dependent children of civil servants of the French State working abroad on the basis of Article 4B(e) of Decree No 2002-22, amounting to monthly payments of EUR 134.20 and EUR 136.41 for those same two years respectively.

21 The salary received by Ms Schulz-Delzers for the two years at issue in the main proceedings was subject to income tax in France. By contrast, the two allowances referred to in the previous paragraph above, being exempt income under French legislation, were not taxed in France.

22 In the tax assessment notices for 2005 and 2006, the Finanzamt applied the exemption to those two allowances but, as with the remainder of Ms Schulz-Delzers' remuneration, took them into account in the progressive application of the tax, in accordance with Paragraph 32b(1)(3) and (2)(2) of the EStG, after deduction of a lump-sum

professional expenses allowance of EUR 920 in respect of each of those two years. The effect of taking into account those allowances was to increase the Schulz spouses' income tax by EUR 654 and EUR 664 for the years 2005 and 2006 respectively.

23 The Schulz spouses raised objections to those notices of tax assessment, which were rejected as unfounded by the Finanzamt in its decisions of 30 April 2009.

24 By action brought on 18 May 2009 before the referring court, the Schulz spouses contested taking into account the two allowances at issue in the main proceedings in calculating the tax rate applicable to other income applying the progressive tax rate. They claim that the allowances received by Ms Schulz-Delzers should not be taken into account in the progressive application of the tax. They maintain that taking those allowances into account on that basis infringes Article 39 EC since equivalent allowances received in the conditions laid down in Paragraph 3(64) of the EStG are not similarly taken into account.

25 According to the referring court, Paragraph 3(64) of the EStG is capable of deterring a French civil servant from carrying out an assignment in Germany as part of his service because the allowances at issue in the main proceedings are included in calculating the special tax rate, whereas a German employee working outside German territory receives equivalent allowances which are not taken into account in the progressive application of the tax.

26 Irrespective of the infringement of Article 39(1) to (3) EC, Paragraph 3(64) of the EStG also constitutes, according to the referring court, covert discrimination on grounds of nationality on the ground that, in general, it is German nationals who are employed by a German legal person governed by public law and that, therefore, it is

they who benefit, in the first place, from the advantage flowing from Paragraph 3(64) of the EStG.

27 It is in those circumstances that the Finanzgericht Baden-Württemberg decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

'(1) (a) Is Paragraph 3(64) of the [EStG] compatible with the freedom of movement of workers pursuant to Article [39 EC, now Article 45 TFEU]?

(b) Does Paragraph 3(64) of the [EStG] constitute covert discrimination on grounds of nationality, prohibited by Article [12 EC, now Article 18 TFEU]?

(2) If the reply to the first question is in the negative: is Paragraph 3(64) of the [EStG] compatible with the freedom of movement of Union citizens under Article [18 EC, now Article 21 TFEU]?'

Consideration of the questions referred

28 As a preliminary point it must be held, as stated by the Advocate General in points 39 to 43 of his Opinion, that of the articles of the EC Treaty cited by the referring court in its questions, only Article 39 EC is applicable in the main proceedings.

29 In the first place, Article 12 EC, which lays down a general prohibition of all discrimination on grounds of nationality, applies independently only to situations governed by European Union law for which the Treaty lays down no specific rules of non-discrimination. In relation to the freedom of movement for workers, the principle of non-discrimination was implemented by Article 39 EC (see, inter alia, Case C-269/07 *Commission* v *Germany* [2009] ECR I-7811, paragraphs 98 and 99 and the case-law cited).

30 Second, Article 18 EC, which sets out generally the right of every citizen of the Union to move and reside freely within the territory of the Member States, finds specific expression in Article 39 EC in relation to freedom of movement for workers (see Case C-3/08 *Leyman* [2009] ECR I-9085, paragraph 20 and case-law cited).

31 It is clear that Ms Schulz-Delzers left France in order to reside in Germany and her status as worker within the meaning of Article 39 EC is not in dispute. Thus, it is in the light only of Article 39 EC that it is necessary to examine the questions referred (see, to that effect, inter alia, *Leyman*, paragraphs 18 to 20 and case-law cited).

32 It should also be noted that the question of the compatibility of Paragraph 3(64) of the EStG with Article 39 EC is raised in the main proceedings only to the extent that the said Paragraph 3(64) applies to allowances received by German civil servants working abroad, whereas it does not apply to allowances received by civil servants of another Member State working on German territory. Not at issue, on the other hand, is the fact that that provision of German law is not inter alia applicable to allowances re-

ceived by civil servants of another Member State who are subject to tax in Germany and work in a third Member State.

33 In those circumstances, the questions referred, which should be examined together, must be understood as concerning, in essence, the issue whether Article 39 EC must be interpreted as precluding a provision, such as Paragraph 3(64) of the EStG, according to which allowances such as those at issue in the main proceedings, granted to a civil servant of a Member State working in another Member State in order to compensate for a loss of purchasing power at the place of secondment, are not taken into account in determining the tax rate applicable in that first Member State to other income of the taxpayer or of his spouse, whereas equivalent allowances granted to a civil servant of that other Member State working on the territory of the first Member State are taken into account in determining that tax rate.

34 In that regard, the Court has consistently held that Article 39 EC precludes, first, overt discrimination by reason of nationality and all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result (Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 26) and that that article prohibits, second, provisions which preclude or deter a national of a Member State from leaving his country of origin to exercise his right to freedom of movement (Case C-385/00 *Groot* [2002] ECR I-11819, paragraph 78).

35 In the case in the main proceedings, it is common ground that Ms Schulz-Delzers, who exercised her right to free movement, is not, in the host Member State, treated less favourably than a national of that State would be treated in a purely internal situation. Paragraph 3(64) of the EStG, by its very nature, is not capable of applying to taxpayers working on German territory and it confers an advantage exclusively on taxpayers working outside that territory.

36 It follows that it is only if the refusal to confer that advantage on a taxpayer in Ms Schulz-Delzers' situation could be regarded as discriminatory for other reasons – which presupposes that Ms Schulz-Delzers' situation is comparable to that of the recipients of that advantage – that Article 39 EC could properly be relied upon in the main proceedings.

37 It must be held that no such comparability exists in the light of the objective pursued by the application of a progressive tax scale which is necessarily based, as stated in paragraphs 5 to 8 above, on an assessment of the taxpayer's ability to pay tax carried out on the basis of the living conditions on the territory of the Member State concerned.

38 From that point of view, allowances such as those falling within the scope of Paragraph 3(64) of the EStG, which aim only to permit the recipient to maintain, notwithstanding a higher cost of living abroad, the same living conditions as enjoyed by him in Germany, do not enhance the taxpayer's ability to pay tax and are therefore not taken into account in the progressive application of the tax.

39 By contrast, the allowances enjoyed by Ms Schulz-Delzers in Germany are specifically intended to adjust her remuneration to the cost of living in Germany and therefore enhance her ability to pay tax, as assessed on the basis of living conditions on the territory of that Member State, and are, consequently, taken into account in the progressive application of the tax.

40 The fact that, from the point of view of the French legislature, those allowances aim only to permit the recipient thereof to maintain, notwithstanding a higher cost of living in Germany, the same living conditions as he enjoyed in France, is irrelevant in

that regard since the comparability of the situations can necessarily be assessed only in the context of one and the same tax system and, in the absence of unifying or harmonising measures at European Union level, the Member States retain competence for determining the criteria for taxation on income.

41 The fact that the choice of the Schulz spouses to be jointly assessed for tax purposes in order to benefit from a common tax base, which is more advantageous than two separate tax bases, has the effect of including the allowances paid to Ms Schulz-Delzers in calculating the tax rate on the basis of the progressive tax scale, is thus the consequence not of discriminatory treatment within the meaning of Article 39 EC but of the application of tax criteria which it is for the Member States to determine.

42 In that regard, the Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation. Given the relevant disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage or not, according to circumstances (see, to that effect, Case C-365/02 *Lindfors* [2004] ECR I-7183, paragraph 34, and Case C-403/03 *Schempp* [2005] ECR I-6421, paragraph 45).

43 The answer to the questions referred is therefore that Article 39 EC must be interpreted as not precluding a provision such as Paragraph 3(64) of the EStG, according to which allowances such as those at issue in the main proceedings, granted to a civil servant of a Member State working in another Member State in order to compensate for a loss of purchasing power at the place of secondment, are not taken into account in determining the tax rate applicable in the first Member State to the other income of the taxpayer or of his spouse, whereas equivalent allowances granted to a civil servant

of that other Member State working on the territory of the first Member State are taken into account in determining that tax rate.

Costs

44 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 (Fourth Chamber) hereby rules:

Article 39 EC must be interpreted as not precluding a provision, such as Paragraph 3(64) of the Law on income tax (Einkommensteuergesetz), according to which allowances such as those at issue in the main proceedings, granted to a civil servant of a Member State working in another Member State in order to compensate for a loss of purchasing power at the place of secondment, are not taken into account in determining the tax rate applicable in the first Member State to the other income of the taxpayer or of his spouse, whereas equivalent allowances granted to a civil servant of that other Member State working on the territory of the first Member State are taken into account for the purposes of determining that tax rate.

[Signatures]