JUDGMENT OF THE COURT (Fourth Chamber)

16 June 2011 *

In Case C-10/10,

ACTION under Article 258 TFEU for failure to fulfil obligations, brought on 8 January 2010,

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

applicant,

v

Republic of Austria, represented by C. Pesendorfer, acting as Agent, with an address for service in Luxembourg,

defendant,

* Language of the case: German.

THE COURT (Fourth Chamber),

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

Advocate General: V. Trstenjak,
Registrar: A. Calot Escobar,

having regard to the written procedure,

after hearing the Opinion of the Advocate General at the sitting on 8 March 2011,

gives the following

Judgment

1 By its action the European Commission asks the Court to declare that, by authorising the deduction from tax of gifts to research and teaching institutions exclusively where those institutions are established in Austria, the Republic of Austria has failed to fulfil its obligations under Article 56 EC and Article 40 of the Agreement on the European Economic Area of 2 May 1992 (OJ 1994 L 1, p. 3, 'the EEA Agreement').

Legal context

The EEA Agreement

2 Article 40 of the EEA Agreement provides:

'Within the framework of the provisions of this Agreement, there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in [European Union] Member States or [European Free Trade Association (EFTA)] States and no discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested. Annex XII contains the provisions necessary to implement this Article.'

3 Annex XII to the EEA Agreement, 'Free movement of capital', refers to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [article repealed by the Treaty of Amsterdam] (OJ 1988 L 178, p. 5). Under Article 1(1) of that directive, capital movements are to be classified in accordance with the nomenclature in Annex I to the directive.

National law

4 Paragraph 4 of the Law on income tax (Einkommensteuergesetz) of 7 July 1988 (BGBl. 400/1988, 'the EStG') regards the ascertainment of profit as the basis of assessment of income tax. That paragraph provides that operating expenses are to be deducted from

the profit. Paragraph 4(4) provides inter alia that certain precisely specified items of expenditure 'are in any event' operating expenses.

5 Paragraph 4a(1) of the law, in the version of the Law on tax reform of 2009 (BGBl. I, 26/2009) ('the amended EStG'), which concerns gifts out of operating capital, lists a number of gifts which are also deemed to be operating expenses. In this connection Paragraph 4a of the amended EStG repeats the list of operating expenses which until 31 March 2009 appeared in Paragraph 4(4)(5) of the EStG.

6 Paragraph 4a of the amended EStG reads as follows:

'Also deemed to be operating expenses are:

1. gifts out of operating capital, for carrying out

— research activities or

— teaching activities for adult education which concern academic or artistic teaching and correspond to the Law on universities of 2002,

and producing related academic publications and documentation, to the following institutions:

(a) universities, colleges of art and the Akademie der bildenden Künste, their faculties, institutes and special establishments;

(b) funds established by federal or provincial law entrusted with the promotion of research;

(c) the Österreichische Akademie der Wissenschaften;

(d) legally non-independent establishments of local authorities which are concerned essentially with research or teaching activities of the kind mentioned above for Austrian learning or the Austrian economy and related academic publications or documentation;

(e) legal persons which are concerned essentially with research or teaching activities of the kind mentioned above for Austrian learning or the Austrian economy and related academic publications or documentation. A further condition is that either a local authority has at least a majority participation in those legal persons or the legal person pursues exclusively academic purposes as a corporation within the meaning of Paragraph 34 et seq. of the Federal Tax Code (Bundesabgabenordnung).

The conditions in points (d) and (e) are to be demonstrated by the establishment in question by a decision of the Finanzamt Wien 1/23 (Vienna Tax Office 1/23) issued subject to revocation at any time. All establishments for which such a decision has been issued are to be published at least once a year in electronically appropriate form on the home page of the Bundesminsterium für Finanzen (Federal Ministry of Financial Affairs). The market value of the gifts is deductible in so far as it does not, together with the market value of gifts within the meaning of subparagraph 2, exceed 10 % of the profit of the immediately preceding trading year.

…'

Facts of the dispute and pre-litigation procedure

7 By letter of 12 May 2005 the Commission requested the Federal Ministry of Financial Affairs of the Republic of Austria to state whether the recipients of gifts in accordance with Paragraph 4(4)(5) of the EStG (subsequently Paragraph 4a(1) of the amended EStG) could only be institutions established in Austria or whether they could also be equivalent institutions in other Member States of the European Union (EU) or the European Economic Area (EEA).

8 The Federal Ministry of Financial Affairs replied to that letter by letter of 5 September 2005, in which it confirmed that the recipients of the gifts defined in Paragraph 4(4)(5)(a) to (d) of the EStG could only be Austrian institutions. The application of Paragraph 4(4)(5)(e) of the EStG, on the other hand, in accordance with its wording, was not limited to Austrian institutions.

9 On 4 April 2007 the Commission sent a first letter of formal notice to the Republic of Austria, in which it concluded that Paragraph 4(4)(5)(a) to (e) of the EStG infringed Article 49 EC and Article 36 of the EEA Agreement and invited the Republic of Austria to submit observations on the point within two months from notification of the letter.

10 In its reply of 5 June 2007 the Republic of Austria objected to the application of the provisions on the freedom to provide services, arguing that the gifts regulated by the contested provisions were not consideration for a service. It also denied any infringement of the free movement of capital.

11 In a supplementary letter of formal notice of 6 May 2008, transmitted to the Republic of Austria on 8 May 2008, the Commission supplemented the legal assessment in the first letter of formal notice by stating that, in addition to the freedom to provide services, it based its assessment on the provisions on the free movement of capital, namely Article 56 EC and Article 40 of the EEA Agreement, in that the tax rules in question made gifts to institutions established in other Member States of the EU or the EEA less attractive.

12 The Republic of Austria replied by letter of 9 July 2008, referring essentially to its reply of 5 June 2007 to the effect that there was no breach either of the freedom to provide services or of the free movement of capital.

13 As the Commission was not satisfied with that reply, it adopted a reasoned opinion on 19 March 2009, in which it concluded that the Republic of Austria was in breach of its obligations under Article 56 EC and Article 40 of the EEA Agreement by authorising the deduction from tax of gifts to research and teaching institutions only if those institutions were established in Austria. In its legal analysis of Paragraph 4(4)(5) of the EStG, the Commission distinguished between points (a) to (d) of that provision on the one hand and point (e) on the other. In the Commission's view, the former differentiate according to the seat of the institution concerned. Only gifts to the institutions mentioned in those points and established in Austria can be recognised as deductible operating expenditure. By contrast, while Paragraph 4(4)(5)(e) of the EStG does not distinguish on the basis of the seat of the recipient of a gift, the classification of gifts as operating expenditure is accepted only if the legal person concerned is active essentially on behalf of learning or the economy in Austria.

14 By letter of 25 May 2009 the Republic of Austria reiterated and supplemented the arguments it had already relied on in its replies to the letter of formal notice and the supplementary letter of formal notice. In those circumstances, the Commission decided to bring the present action.

The action

Arguments of the parties

15 According to the Commission, by authorising the deduction from tax solely of gifts to research and teaching institutions whose seat is in Austria, to the exclusion of gifts to comparable institutions established in other Member States of the EU or the EEA, Paragraph 4a(1)(a) to (d) of the amended EStG is contrary to the free movement of capital as guaranteed by Article 56 EC and Article 40 of the EEA Agreement.

16 That provision of Austrian law is prohibited in principle by Article 56 EC and is not capable of being justified. It is clear from the wording of the provision and from the arguments put forward by the Republic of Austria in the pre-litigation procedure that the provision draws a distinction according to purely geographical criteria, namely whether the seat of the recipient of the gifts is in Austria. Those considerations relating to Article 56 EC all apply *mutatis mutandis* to Article 40 of the EEA Agreement.

17 The Republic of Austria concedes that Paragraph 4a(1)(a) to (d) of the amended EStG distinguishes to some extent between institutions established in Austria and those established in other Member States, but considers that the provision does not constitute a restriction of the free movement of capital. First, it submits that the research and teaching institutions listed in Paragraph 4a(1)(a) to (d) of the amended EStG are not objectively comparable with similar institutions established in other Member States, as only the former are subject to the influence of the official authorities of the Republic of Austria.

18 Secondly, in so far as a restriction of the free movement of capital is shown to exist, the Republic of Austria submits that it is justified by an overriding reason in the public interest. More particularly, the limitation of the benefit of deductibility from tax to gifts to the institutions listed in Paragraph 4a(1)(a) to (d) of the amended EStG corresponds to the objective, in the general interest of the Austrian public, of maintaining and supporting the position of Austria as a centre of culture and learning. Establishments not covered by Paragraph 4a(1)(a) to (d) of the amended EStG may, however, as may comparable establishments in Member States other than the Republic of Austria, benefit from deductibility from tax of gifts under Paragraph 4a(1)(e) of the amended EStG if they pursue objectives in the public interest in the field of learning and the economy.

19 The forgoing of tax revenue as a result of the deductibility from tax of gifts to the research and teaching institutions listed in Paragraph 4a(1)(a) to (d) of the amended EStG is justified because those institutions make a contribution to the public interest by providing their services and the gifts can take the place of the payment of taxes. Deductibility from tax of gifts on the basis of those provisions thus enables additional financial means to be made available for tasks in the public interest.

20 The limitation of the deductibility from tax of gifts to the research and teaching institutions listed in Paragraph 4a(1)(a) to (d) of the amended EStG is appropriate and necessary for attaining the aim pursued. An extension of that deductibility to institutions established in Member States other than the Republic of Austria could not guarantee the same objectives, because it would have the consequence that part of the gifts in question, deductible to the extent of 10 % of the profit of the donor establishment, would benefit institutions which pursue objectives that are not in the public interest of the Republic of Austria, which would reduce correspondingly the means of institutions established in that Member State.

Findings of the Court

21 In the present proceedings, it must be observed at the outset that, as may be seen from its application, the Commission refers only to Paragraph 4a(1)(a) to (d) of the amended EStG, not to Paragraph 4a(1)(e).

22 The Commission submits essentially that, by authorising the deduction from tax of gifts to the institutions listed, Paragraph 4a(1)(a) to (d) of the amended EStG draws a distinction according to the sole criterion of the seat of the recipient of the gift, which it regards as incompatible with the requirements of Article 56 EC and Article 40 of the EEA Agreement.

23 It must be recalled that, according to settled case-law, while direct taxation falls within the competence of the Member States, they must none the less exercise that competence consistently with European Union law (see, inter alia, Case C-72/09 *Établissements Rimbaud* [2010] ECR I-10659, paragraph 23 and the case-law cited).

24 Article 56(1) EC prohibits all restrictions on the movement of capital between Member States and between Member States and non-member countries. While the EC Treaty does not define 'movement of capital', it is common ground that Directive 88/361, together with the nomenclature annexed to it, has indicative value for defining that term (see Joined Cases C-282/04 and C-283/04 *Commission* v *Netherlands* [2006] ECR I-9141, paragraph 19). Gifts and endowments appear in point XI, 'Personal capital movements', of Annex I to Directive 88/361.

25 In the present case, the amended EStG provides for the deduction from tax of gifts out of operating capital made to the research and teaching institutions listed in Paragraph 4a(1)(a) to (e). As the Republic of Austria acknowledged in the pre-litigation procedure, the recipients of the gifts defined in points (a) to (d) of Paragraph 4a(1) can only be institutions whose seat is in the Republic of Austria.

26 Consequently, the system of tax deductions in question entails, for taxpayers making gifts to research and teaching institutions established in Member States other than the Republic of Austria, a greater tax burden than for taxpayers making gifts to the institutions listed in Paragraph 4a(1)(a) to (d) of the amended EStG. Since the possibility of obtaining a tax deduction can have a significant influence on the donor's attitude, the non-deductibility of gifts to research and teaching institutions established in Member States other than the Republic of Austria may discourage taxpayers from making gifts to them (see, to that effect, Case C-318/07 *Persche* [2009] ECR I-359, paragraph 38).

27 Paragraph 4a(1)(a) to (d) of the amended EStG therefore constitutes a restriction of movements of capital prohibited in principle by Article 56(1) EC.

28 However, in accordance with Article 58(1)(a) EC, Article 56 EC is without prejudice to the right of Member States 'to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation … with regard to the place where their capital is invested'. That derogation is itself limited by Article 58(3) EC, which provides that the national measures referred to in Article 58(1) EC 'shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56'. The differences in treatment authorised by Article 58(1)(a) EC must therefore be distinguished from the discrimination prohibited by Article 58(3) EC.

29 According to the Court's case-law, for national tax legislation such as that at issue, which distinguishes between gifts to national institutions and those to institutions established in other Member States, to be regarded as compatible with the Treaty provisions on the free movement of capital, the difference in treatment must concern situations which are not objectively comparable, or must be justified by an overriding reason in the public interest. In order to be justified, moreover, the difference in treatment must not go beyond what is necessary to attain the objective of the legislation in question (see, to that effect, Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] ECR I-8203, paragraph 32, and *Persche*, paragraph 41).

30 The Republic of Austria submits, first, that the institutions listed in Paragraph 4a(1)(a) to (d) of the amended EStG are not objectively comparable to the corresponding research and teaching institutions established in other Member States. In so far as the tax rules concerning the gifts at issue lead to different treatment of taxpayers depending on the place where their capital is invested, the Republic of Austria argues that the difference in treatment between Austrian taxpayers making gifts to

the institutions listed in Paragraph 4a(1)(a) to (d) of the amended EStG, on the one hand, and those making gifts to the corresponding institutions established in other Member States, on the other, is permitted in view of the differences between the recipients of the gifts.

31 According to the Republic of Austria, the difference is justified by the influence of the official authorities in Austria over the institutions listed in Paragraph 4a(1)(a) to (d) of the amended EStG, an influence not present in the case of institutions established in other Member States. That influence enables the official authorities to define the objectives in the public interest assigned to the institutions listed in those provisions, to direct them actively in the pursuit of those objectives, and to intervene if the objectives are not attained.

32 It must be stated in this respect that, while the Member States are free to define the objectives in the public interest that they wish to promote by granting tax advantages to private or public bodies which pursue those objectives in a disinterested manner and comply with the requirements relating to their implementation, they must exercise that discretion in accordance with the law of the European Union (see, to that effect, *Persche*, paragraph 48). Although it is true that the national authorities have additional means available to them for supervising and influencing the conduct of institutions established in Austrian territory compared to those established in other Member States, the Republic of Austria has failed to show that such intervention in the management of the institutions in question is necessary for guaranteeing the attainment of the objectives in the public interest which that Member State seeks to promote.

33 Moreover, while a Member State can lawfully reserve the grant of tax advantages to bodies pursuing certain objectives in the public interest, it cannot, however, reserve the benefit of those advantages solely to bodies established in its territory (see, to that effect, *Persche*, paragraph 44).

34 In the present case, the Republic of Austria states that the objective in the public interest pursued by Paragraph 4a(1) of the amended EStG is the promotion of Austria's position as a centre of learning and teaching. As the Advocate General observes in point 56 of her Opinion, that objective is defined in such a way that almost all research and teaching institutions whose seat is in Austria comply, whereas any corresponding institution established in another Member State is automatically excluded from the benefit of the tax advantage at issue.

35 It follows that the sole criterion capable of distinguishing between taxpayers making gifts to institutions whose seat is in Austria and those making gifts to corresponding institutions established in other Member States is in fact the place of establishment of the recipient of the gift. Such a criterion, by definition, cannot be a valid criterion for assessing the objective comparability of the situations or, consequently, for establishing an objective difference between them (see, by analogy, with respect to freedom to provide services, Case C-76/05 *Schwarz and Gootjes-Schwarz* [2007] ECR I-6849, paragraphs 72 and 73).

36 The Republic of Austria's argument that the institutions listed in Paragraph 4a(1)(a) to (d) of the amended EStG, on the one hand, and the corresponding research and teaching institutions established in other Member States, on the other, are not in an objectively comparable situation, and consequently that the difference in treatment between taxpayers subject to income tax in Austria according to the place where their capital is invested is justified, must therefore be rejected.

37 As regards, secondly, the argument that there is an overriding reason in the public interest, while the Court indeed held in Case C-39/04 *Laboratoires Fournier* [2005] ECR I-2057, paragraph 23, that the promotion of research and development may constitute such a reason, it nevertheless considered that national legislation reserving the benefit of a tax credit solely to research carried out in the Member State concerned

was directly contrary to the objective of European Union policy in the field of research and technical development. In accordance with Article 163(2) EC, that policy aims in particular to remove the fiscal obstacles to cooperation in the field of research, and cannot therefore be implemented by the promotion of research and development at national level. The same is true of the tax rules concerning gifts at issue in the present case, in so far as the Republic of Austria relies on that objective to limit the deductibility of gifts to Austrian research establishments and universities.

38 In so far as the Republic of Austria relies on the objective of promoting national education and training, even assuming that such an objective can constitute an overriding reason in the public interest capable of justifying a restriction of the free movement of capital, a restrictive measure must nevertheless comply with the principle of proportionality in order to be justified. In this respect, it is clear that the Republic of Austria has not put forward any argument to show that the objective it pursues in this field could not be achieved without the contested legislation and could not be achieved by applying less restrictive measures as regards the possibility for Austrian taxpayers to choose the recipients of the gifts they wish to make.

39 The Republic of Austria confines itself to submitting, moreover in general terms, that the effect of extending the benefit of deductibility from tax to gifts to institutions established in other Member States would be a partial displacement of the gifts currently directed to Austrian institutions and hence a reduction of the means made available to them as a result of income from gifts. It argues that the funds deriving from private gifts supplement those institutions' budgets, so that the deductibility from tax of the gifts at issue makes it possible to place additional financial means at their disposal without increasing budgetary expenditure.

40 As far as this argument is concerned, it is settled case-law that the need to prevent the reduction of tax revenues is neither among the objectives stated in Article 58 EC nor an overriding reason in the public interest capable of justifying a restriction on a freedom instituted by the Treaty (see, to that effect, *Persche*, paragraph 46 and the case-law cited).

41 It follows that the restriction of the free movement of capital resulting from the rules at issue cannot be justified on the grounds relied on by the Republic of Austria.

42 Since the provisions of Article 40 of the EEA Agreement have the same legal scope as the substantially identical provisions of Article 56 EC (see Case C-521/07 *Commission* v *Netherlands* [2009] ECR I-4873, paragraph 33, and *Établissements Rimbaud*, paragraph 22), all the above considerations may, in circumstances such as those of the present case, be transposed *mutatis mutandis* to Article 40.

43 It follows from all the foregoing that Paragraph 4a(1)(a) to (d) of the amended EStG, in that it limits the deductibility of gifts for income tax purposes to those made to institutions whose seat is in Austria, constitutes a restriction of the free movement of capital enshrined in Article 56 EC and Article 40 of the EEA Agreement.

44 It must therefore be held that, by authorising the deduction from tax of gifts to research and teaching institutions exclusively where those institutions are established in Austria, the Republic of Austria has failed to fulfil its obligations under Article 56 EC and Article 40 of the EEA Agreement.

Costs

45 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 Commission has applied for costs and the Republic of Austria has been unsuccessful, it must be ordered to pay the costs.

On those grounds, the Court (Fourth Chamber) hereby

1. **Declares that, by authorising the deduction from tax of gifts to research and teaching institutions exclusively where those institutions are established in Austria, the Republic of Austria has 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 Republic of Austria to pay the costs.**

[Signatures]