OPINION OF ADVOCATE GENERAL KOKOTT
delivered on 25 March 2010[1]

I – Introduction

1. In the present action for failure to fulfil obligations, the Commission alleges that the Portuguese Republic taxes interest which non-resident credit institutions receive in Portugal more heavily than the income from interest received by resident credit institutions. It claims that in the case of cross-border interest payments tax at source of up to 20% is levied on gross income. The refinancing costs associated with the grant of loans cannot be deducted. By contrast, in the case of national recipients only net income is liable to corporation tax of 25%.

2. In the view of the Commission, Portugal thereby infringes the freedom to provide services and the free movement of capital which are guaranteed in the EC Treaty and the Agreement of 2 May 1992 on the European Economic Area (EEA Agreement). [2]

3. In its own defence, the Portuguese Republic maintains primarily that the Commission failed to furnish factual evidence that non-resident credit institutions are taxed more heavily. In the alternative, it contends that non-resident and resident credit institutions are not in a comparable situation. Non-resident creditors are subject to limited tax liability in respect of interest on income generated in Portugal. Therefore, the source State must, according to the case-law of the Court, [3] take account only of the costs directly connected with economic activity in that State. However, refinancing costs cannot be attributed to individual loans. Consequently, it is not possible to determine those costs, which are directly connected with non-resident banks' income from interest generated in Portugal.

4. In the case of resident taxable persons, by contrast, net income can be established without difficulty. Since they are liable to tax in Portugal on their worldwide income, they can

1 — Original language: German.

2 — OJ 1994 L 1, p. 3.

3 — See Case C-234/01 *Gerritse* [2003] ECR I-5933, paragraph 27; Case C-346/04 *Conijn* [2006] ECR I-6137, paragraph 20; Case C-290/04 *FKP Scorpio Konzertproduktionen* [2006] ECR I-9461, at paragraph 52; Case C-345/04 *Centro Equestre da Lezíria Grande* [2007] ECR I-1425, paragraphs 23 to 25; and Case C-11/07 *Eckelkamp and Others* [2008] ECR I-6845, paragraph 50.

deduct their entire operating costs from that income without the need to ascribe costs to specific income.

5. The Commission regards the present proceedings as a test case and proceeds on the assumption that other Member States also tax non-resident banks' income from interest in accordance with similar rules which are guided by the Model Convention on Double Taxation concerning Income and Capital of the Organisation for Economic Cooperation and Development ('the OECD Model Convention').

6. Unlike the situation with regard to the taxation of cross-border dividend distributions, the Court has yet to rule specifically on the taxation of cross-border interest payments in the source State. Reference should be made at most to the judgment in *Truck Center*, [4] which concerns interest payments between associated undertakings. Such interest payments are now to be exempted from taxes at source under Directive 2003/49/EC. [5] The taxation of interest payments to non-resident natural persons is also governed by Community law. [6] However, there is no secondary legislation governing the tax treatment of interest payments to credit institutions resident in another Member State which are not associated with the debtor.

II – Legal context

7. The Community-law context of the present proceedings is formed by Articles 49 EC and 56 EC, which guarantee respectively the freedom to provide services and the free movement of capital. Articles 36 and 40 of the EEA Agreement, which are also cited, correspond in all essential respects to those provisions of the EC Treaty.

8. Under Article 4(2) of the Portuguese *Código do Imposto sobre o Rendimento das Pessoas Colectivas* [7] (Corporation Tax Code; 'the CIRC') legal persons and other legal entities which are not resident in Portugal are liable to tax only in respect of income generated in

4 — Case C-282/07 *Truck Center* [2008] ECR I-10767.

5 — Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (OJ 2003 L 157, p. 49).

6 — Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments (OJ 2003 L 157, p. 38).

7 — Decree-Law No 442-B/88 of 30 November 1988, as amended by Decree-Law No 211/2005 of 7 December 2005, *Diário da República I*, Series A, No 234 of 7 December 2005.

Portugal. Under Article 4(3)(c) of the CIRC, the following income of non-residents from a Portuguese source is liable to tax: capital assets in respect of which the persons liable to pay revenue are resident in Portugal, or established or managed there, and payments attributable to permanent establishments situated in Portugal.

9. Under Article 88(1), (3)(b) and (5) of the CIRC, in the case of non-resident recipients tax is to be levied at source as definitive tax. Under Article 80(2)(c) of the CIRC, the tax rate amounts to 20%. The bilateral Conventions for the Avoidance of Double Taxation (DTCs), which Portugal has concluded with all Member States other than Cyprus, and with all EEA States other than Liechtenstein, provide for a reduction in tax at source to 10%, 12% or 15%. In that respect the DTCs provide, in accordance with the OECD Model Convention, that taxes at source are to be levied on the gross income of a non-resident recipient.

10. By contrast, the income of Portuguese recipients is subject to general corporation tax of 25% (Article 80(1) of the CIRC). However, in their case tax is levied only on net income, that is to say, on income from interest after the deduction of operating costs, including refinancing costs.

III – Pre-litigation procedure and the action brought

11. In the pre-litigation procedure, which was conducted in the proper manner, the Commission alleged that the Portuguese Republic taxes mortgage interest and interest on other loans which Portuguese debtors pay to financial institutions in another Member State or EEA State more heavily than similar interest payments to Portuguese recipients. This, according to the Commission, infringes Articles 49 EC and 56 EC and the corresponding provisions of the EEA Agreement. As the Commission remained unconvinced by the defence put forward by the Portuguese Republic, it brought the present action on 6 March 2008, in which it is seeking:

— a declaration that, by taxing payment of interest abroad more heavily than payment of interest to entities resident in Portuguese territory, the Portuguese Republic imposes restrictions on the provision of mortgage and other loan services, and has therefore failed to fulfil its obligations under Articles 49 EC and 56 EC and Articles 36 and 40 of the EEA Agreement;

— an order that the Portuguese Republic should pay the costs.

12. The Portuguese Republic contends that the Court should dismiss the action and award costs against the Commission.

13. By order of 4 August 2008 the President of the Court granted the Republic of Lithuania leave to intervene in support of the form of order sought by the Portuguese Republic.

IV – Legal assessment

A – *Complaint of infringement of Articles 49 EC and 56 EC*

1. Applicable fundamental freedom

14. According to established case-law, in order to determine whether national legislation falls within the scope of one or other of the freedoms of movement, the purpose of the legislation concerned must be taken into consideration. [8]

15. Under the rules at issue, all capital amounts received by foreign legal entities are liable to tax at source. Therefore, these also cover, according to their wording, loan interest or other cash flows between undertakings the principal purpose of which does not consist in the supply of financial services.

16. However, the subject-matter of the action brought by the Commission concerns only the tax treatment of interest which financial institutions receive in respect of the loans which they have granted. It is settled case-law that the business of a credit institution consisting in the granting of credit constitutes a service within the meaning of Article 49 EC. [9]

17. It is true that, in the context of financial services, loan proceeds and the interest must be transferred from one Member State to another. These cross-border financial flows in principle also constitute capital and payment transactions. However, they serve merely to complete a credit transaction which essentially constitutes a service.

18. As to whether Article 56 EC is applicable, it must therefore be noted that any restrictive effects which the national legislation at issue might have on the free movement of capital and payments would be no more than the inevitable consequence of any restrictions on

8 — Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraphs 31 to 33; Case C-452/04 *Fidium Finanz* [2006] ECR I-9521, paragraphs 34 and 44 to 49; and Case C-311/08 *SGI* [2010] ECR I-487, paragraph 25.

9 — Case C-484/93 *Svensson und Gustavsson* [1995] ECR I-3955, paragraph 11; Case C-222/95 *Parodi* [1997] ECR I-3899, paragraph 17; and *Fidium Finanz*, cited in footnote 8, paragraph 39.

the freedom to provide services. Where a national measure relates to several fundamental freedoms at the same time, the Court will in principle examine the measure in relation to only one of those freedoms if it appears, in the circumstances of the case, that the other freedoms are entirely secondary in relation to the first and may be considered together with it. [10]

19. Consequently, the provisions under challenge should be examined solely in the context of the freedom to provide services.

20. In *Fidium Finanz* the Court also attributed the granting of credit on a commercial basis to the area covered by the freedom to provide services. The Court allowed that freedom to prevail over the free movement of capital, which was affected only incidentally, even though Fidium Finanz was able, as an undertaking established in a non-member country, to rely solely on that fundamental freedom. [11]

21. The Commission takes the view that those findings as to the relationship between the freedom to provide services and the free movement of capital correspond only to the case of an undertaking resident in a non-member country, which is not the position here. The Court sought to ensure that the restriction to Member-State nationals of the freedom to provide services could not be circumvented by a parallel application of the free movement of capital.

22. However, this argument put forward by the Commission is refuted by a large number of decisions of the Court which related to purely intra-Community situations and in which the Court ruled on the competitive relationship between various fundamental freedoms in the same way as it did in *Fidium Finanz*. [12]

2. Restriction on the freedom to provide services

23. According to settled case-law, Article 49 EC precludes the application of any national rules which have the effect of making the provision of services between Member States

10 — *Fidium Finanz*, cited in footnote 8, paragraph 34, and Case C-42/07 *Liga Portuguesa de Futebol Profissional and Bwin International* [2009] ECR I-7633, paragraph 47.

11 — *Fidium Finanz*, cited in footnote 8, paragraphs 47 to 49.

12 — See, inter alia, *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited in footnote 8, paragraph 33; Case C-231/05 *Oy AA* [2007] I-6373, paragraph 24; Case C-182/08 *Glaxo Wellcome* [2010] ECR I-6373, paragraphs 37 and 50; and *SGI*, cited in footnote 8, paragraph 23 et seq.

more difficult than the provision of services purely within a Member State. [13]

24. In particular, a situation in which tax provisions of a Member State which apply to cross-border economic activities are less favourable than those which apply to an economic activity pursued within the borders of that Member State constitutes an example of a restriction which is prohibited by Article 49 EC. [14]

25. Furthermore, the freedom to provide services implies the abolition of any discrimination against a service provider by reason of its nationality or of the fact that it is established in a Member State other than that in which the service is to be provided. [15]

26. It is common ground between the parties that income from interest from a Portuguese source is treated differently depending on whether the taxable person is resident in Portugal or in another Member State or an EEA State.

27. Thus, the difference in treatment is directly connected with the taxable person's place of establishment, which, in the case of companies for the purposes of Article 48 EC, serves, in the same way as nationality in the case of individuals, as the connecting factor with the legal system of a Member State. [16] Therefore, it is necessary to consider in what follows whether the Portuguese provisions at issue amount to prohibited discrimination. That would be the case if the tax treatment of the income from interest of non-resident credit institutions were less favourable than the taxation of similar income of residents.

28. In that regard, the Commission contends that the Portuguese Republic taxes the income from interest of non-resident credit institutions more heavily because the taxes are levied on the gross amount, whereas in the case of residents the net income forms the taxable basis. Banks can achieve only small profits margins on the European market, which is highly transparent on account of the single currency and the harmonised rules governing banks. Therefore, the difference in the basis of assessment results in a significantly heavier tax burden on non-resident recipients.

29. The Commission explains this connection by means of an arithmetical example in which it proceeds on the basis that a credit institution's profit makes up 10% of gross income and that therefore no post-tax profit can be made if the rate of tax at source is also 10%.

13 — Case C-381/93 *Commission* v *France* [1994] ECR I-5145, paragraph 17; Case C-157/99 *Smits and Peerbooms* [2001] ECR I-5473, paragraph 61; Case C-281/06 *Jundt* [2007] ECR I-12231, paragraph 52; and Case C-314/08 *Filipiak* [2009] ECR I-11049, paragraph 61.

14 — *Filipiak*, cited in footnote 13, paragraph 62.

15 — See, inter alia, Case C-490/04 *Commission* v *Germany* [2007] ECR I-6095, paragraph 83, and Case C-546/07 *Commission* v *Germany* [2010] ECR I-439, paragraph 39.

16 — See, inter alia, *Truck Center*, cited in footnote 4, paragraph 32.

30. The Portuguese Government disputes the contention that non-resident credit institutions are subject to less favourable tax arrangements than residents and also supports its argument with the aid of an arithmetical example in which lower operating costs, and thus a greater profit margin, are assumed. Supported by the Lithuanian Government, it also alleges thatthe Commission failed to prove the actual existence of a restriction and has relied on mere suppositions.

31. The connection between the basis of assessment and the tax rate can be explained by reference to the table below, which also contains the arithmetical examples of the Commission and the Portuguese Government.

Gross income from interest	Operating costs	Net income	Non-resident: tax on gross income			Resident: 25% tax on net income
			10%-DTC	15%-DTC	20% without DTC	
€ 10000	€ 0	€ 10000	€ 1000	€ 1500	€ 2000	€ 2500
€ 10000	€ 1000	€ 9000	€ 1000	€ 1500	€ 2000	€ 2250
€ 10000	€ 2000	€ 8000	€ 1000	€ 1500	€ 2000	€ 2000
€ 10000	€ 3000	€ 7000	€ 1000	€ 1500	€ 2000	€ 1750
€ 10000	€ 4000	€ 6000	€ 1000	€ 1500	€ 2000	€ 1500
€ 10000 *	€ 5000	€ 5000	€ 1000	€ 1500	€ 2000	€ 1250
€ 10000	€ 6000	€ 4000	€ 1000	€ 1500	€ 2000	€ 1000
€ 10000	€ 7000	€ 3000	€ 1000	€ 1500	€ 2000	€ 750
€ 10000	€ 8000	€ 2000	€ 1000	€ 1500	€ 2000	€ 500
€10000 **	€ 9000	€ 1000	€ 1000	€ 1500	€ 2000	€ 250
€ 10000	€ 10000	€ 0	€ 1000	€ 1500	€ 2000	€ 0

* Portuguese Government example,
** Commission example

32. The table shows that in the case of non-residents the tax remains the same despite the different level of the operating costs, whereas the tax owed by residents falls in proportion to the level of the operating costs. Where the DTC tax rate of 10% applies, the taxation of non-residents is heavier as soon as the operating costs exceed 60% of gross income or the net income is 40% or less of gross income. At a rate of tax at source of 15% and 20%, the unfavourable taxation of non-residents starts at the point where operating costs are 40% and 20% of gross income respectively.

33. As the governments taking part in the proceedings have correctly pointed out, the Court has consistently held in infringement proceedings under Article 226 EC that it is for the Commission to prove the existence of the alleged Treaty infringement. The Commission must deliver to the Court the necessary evidence, on the basis of which the Court can decide whether there has been any such infringement, and in this the Commission may not rely on suppositions. [17]

34. At the hearing the Commission stressed that it had established that non-residents are treated less favourably than residents because they are unable to deduct any operating costs from the basis of assessment. It is for the defendant to show that this difference arising from the lower tax rates does not result in heavier taxation of non-residents.

35. However, in doing so the Commission fails to appreciate the allocation of the duty to adduce evidence and the burden of proof. In its capacity as applicant, it must present all the facts which substantiate conclusively the allegation of infringement, as formulated in the application. The Commission has not sought a declaration that the Portuguese Republic has failed to fulfil its obligations under the Treaty by laying down different bases for assessment. Rather, its allegation is essentially that non-residents' income from interest is taxed more heavily than is residents' income from interest. Consequently, it must present the facts and evidence which substantiate this allegation.

36. As the table at point 31 shows, the level of the tax burden depends on two factors, namely the tax rate and the basis of assessment. It is common ground that the rates for tax on interest payments to non-resident credit institutions are lower than the general rate of corporation tax to which residents are liable by virtue of their income from interest. By contrast, the basis of assessment in respect of the tax at source on cross-border interest

17 — Case C-62/89 *Commission* v *France* [1990] ECR I-925, paragraph 37; Case C-341/02 *Commission* v *Germany* [2005] ECR I-2733, paragraph 35; and Case C-401/06 *Commission* v *Germany* [2007] ECR I-10609, paragraph 27.

payments is broader because it cannot be reduced by deducting operating costs.

37. Whether or not this fact results in a heavier tax burden for credit institutions resident in another Member State, despite the application of lower tax rates, depends on the actual scope of the basis of assessment for resident credit institutions as a comparator group. Unlike the basis of assessment for non-resident recipients of interest, this figure will vary depending on how high the operating costs are in relation to gross income. Only if the tax basis in the case of residents were reduced by the deduction of operating costs to the extent that the tax payable thereon were lower, despite the higher tax rate, than the tax at source on gross income, would the failure to fulfil obligations be proven.

38. As regards the scope of the basis of assessment, the Commission contended that the banks' profit margin reached at most the scale which it took as a basis in its arithmetical example (10% of gross income) on account of the competition situation in the internal market. If that were true, the lower tax rate applicable to outgoing interest would be insufficient to offset the disadvantage which non-resident credit institutions experience as a result of not being able to deduct operating costs. Instead, the tax at source would consume the entire profit and make a cross-border credit transaction economically absurd from the outset. [18]

39. The Portuguese Government disputes that contention. Although its own arithmetical example is not entirely unequivocal, since it is based on refinancing costs which exclude the possibility of non-resident banks being treated less favourably only if the most favourable DTC tax rate is applied, [19] the Portuguese Government did not, by giving this example, concede that the refinancing costs must in fact be expected at the level which it itself took as a basis. Rather, the example merely serves to illustrate the fact that different results can arise depending on the changes made to the notional parameters.

40. Since the Commission's assertions are therefore disputed, it ought to have furnished concrete evidence relating to the actual relationship between the gross income and operating costs of credit institutions in Portugal. However, throughout the proceedings, including the hearing, it relied solely on hypothetical calculations presented as examples. Although the Commission does not have to show that the taxation of non-residents is heavier than that of residents in every individual case, [20] it must nevertheless demonstrate that failure to fulfil obligations is possible from a factual point of view. For example,

18 — See the table at point 31 of this Opinion.

19 — See the sixth row of the table at point 31 of this Opinion.

20 — See, to this effect, judgment of 23 April 2009 in Case C-406/07 *Commission* v *Greece*, paragraph 27.

it could have furnished statistical data or provided information on the level of interest on bank loans and the refinancing conditions for banks in order to demonstrate the plausibility of its assumptions.

41. Since the Commission adduced nothing of that kind, the heavier taxation of interest payments to non-resident recipients remains a mere presumption which was not supported by facts. Consequently, the Commission has failed to prove the failure to fulfil Treaty obligations which it alleges.

42. It would also be conceivable to base the failure to fulfil obligations on different arguments.

43. Regardless of the specific level of the refinancing costs, the Portuguese rules make it difficult for credit institutions resident in another Member State to enter into competition with Portuguese institutions and to gain access to the Portuguese market.

44. Where a bank from another Member State reduces its interest rates, even though refinancing costs remain unchanged, and accepts a smaller profit in order to attract customers in Portugal, the amount of tax payable in Portugal drops, not in accordance with the reduced margin, but only in accordance with the reduced gross amount. The relative tax burden of the profit increases.

45. By contrast, Portuguese undertakings pay tax only on their net income. If their profit falls, the tax also decreases correspondingly. Therefore, the relative tax burden of the profit does not change. Consequently, it makes it considerably more difficult for foreign banks to enter into price-based competition with Portuguese banks because, where a certain profit margin is not attained, there is heavier taxation of cross-border interest payments than that which residents have to bear in respect of similar income. [21]

46. To put it another way, in order not to make a loss, foreign banks must attain a margin at least equal to the tax at source. Portuguese banks can undercut them and still make a profit after tax.

47. Of course, the Commission did not allege there was such an effect. Consequently, the Portuguese Republic was unable to defend itself properly against the implication that market access for foreign credit institutions

21 — See, in this context, Case C-442/02 *CaixaBank France* [2004] ECR I-8961, paragraph 12 et seq., in which the Court also expressed the view that the prohibition of the remuneration of sight accounts also posed an obstacle to market access.

is being impeded. Therefore, in the present proceedings the finding that obligations have not been fulfilled cannot be based on this particular aspect.

48. Consequently, the action in respect of the infringement of Article 49 EC must be dismissed because the Commission has failed to furnish sufficient evidence that the Portuguese Republic taxes payments of interest to credit institutions resident in another Member State more heavily than it taxes the payment of interest to institutions resident in Portuguese territory.

B – *Complaint of infringement of Articles 36 and 40 of the EEA Agreement*

49. The Court has already held that the guarantees provided by Article 36 of the EEA Agreement and Article 49 EC must be given an identical and uniform interpretation. [22] It has also made the same finding in relation to Article 40 of the EEA Agreement and Article 56 EC. [23] Therefore, the findings made in relation to the alleged infringements of the provisions of the EC Treaty apply in corresponding fashion to Articles 36 and 40 of the EEA Agreement. [24]

50. In that regard, too, the Commission has failed to prove that interest payments to credit institutions resident in an EEA State are taxed more heavily because it did not provide factual information on the level of income and operating costs.

C – *Interim conclusion*

51. Finally it should be emphasised that the Commission has failed to furnish proof of an infringement of the freedom to provide services guaranteed in Article 49 EC and Article 36 of the EEA Agreement, which is the sole criterion by which the matters at issue in this case fall to be assessed. Consequently, the action must be dismissed in its entirety.

22 — Case C-522/04 *Commission* v *Belgium* [2007] ECR I-5701, paragraph 44 et seq.

23 — Case C-540/07 *Commission* v *Italy* [2009] ECR I-10983, paragraph 65 et seq.

24 — However, a difference may arise where the exchange of information between the tax authorities is at issue inasmuch as Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336, p. 15), as amended by Council Directive 92/12/EEC of 25 February 1992 (OJ 1992 L 76, p. 1), does not apply in the EEA States (see *Commission* v *Italy*, cited in footnote 23, paragraph 70 et seq., and point 74 et seq. of my Opinion in that case).

52. However, in this respect it cannot be denied that the structure of the tax on non-resident credit institutions' income from interest could constitute a considerable impediment to the free provision of services if the Commission's assumptions concerning the level of the refinancing costs were correct.

53. In those circumstances no view can be taken on the question at the heart of this case, namely whether what may be a significantly heavier, or even prohibitive, tax burden on non-resident credit institutions can be justified on the ground that they are not in a situation comparable to that of resident institutions with regard to refinancing costs.

54. In particular, the question must remain open as to whether non-residents' costs have a direct economic connection [25] with their income in the host Member State only in the case where they can also be attributed *individually* to the income or whether, perhaps, a pro rata apportionment of global costs is required. However, if the latter is the case, the difficult question would then arise as to how those pro rata costs are to be determined in practice in view of the particular nature of the banking industry.

25 — See, to that effect, *Gerritse*, cited in footnote 3, paragraph 27, and *Centro Equestre da Lezíria Grande*, cited in footnote 3, paragraphs 23 and 25.

V – Costs

55. 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 been unsuccessful in its submissions and the Portuguese Republic has applied for costs to be awarded against it, the Commission must be ordered to pay the costs. In accordance with Article 69(4) of the Rules of Procedure, Member States which have intervened in proceedings must bear their own costs.

VI – Conclusion

56. I accordingly propose that the Court:

(1) dismiss the action;

(2) order the Commission to pay the costs, with the exception of the costs incurred by the Republic of Lithuania;

(3) order the Republic of Lithuania to bear its own costs.