OPINION OF ADVOCATE GENERAL
LÉGER
delivered on 9 March 2006 [1]

1. In this reference for a preliminary ruling, the Court is asked to state whether a situation whereby a national of a Member State with restricted income tax liability in another Member State, in this case the Federal Republic of Germany, may not deduct from his taxable income costs incurred by him in obtaining tax advice for the purpose of fulfilling his tax obligation in that Member State, while a person with unrestricted tax liability in that Member State is entitled to deduct such costs, is contrary to Community law.

I — Relevant national provisions

2. Under the Law on Income Tax (Einkommensteuergesetz), in its 1997 version ('EStG 1997'), [2] it is necessary to draw a distinction between persons with unrestricted income tax liability and those with restricted income tax liability. Unlike persons with unrestricted liability, persons with restricted liability are those who have no permanent residence or usual abode in Germany and are taxed there solely on income received in that Member State.

3. Under Paragraph 49(1)(2)(a) of the EStG 1997, such income arising in Germany includes business income.

4. Paragraph 50(1) of the EStG 1997 includes specific provisions applicable to persons with restricted income tax liability in Germany. It follows from those provisions, in particular, that those persons may not deduct from their taxable income 'special expenditure', such as costs incurred in obtaining tax advice, [3] while persons with unrestricted liability may deduct such costs under Paragraph 10(1)(6) of the EStG 1997.

1 — Original language: French.

2 — BGBl. 1997 I, p. 823 et seq

3 — See Paragraph 50(1), fifth sentence, of the EStG 1997.

5. Furthermore, it should be noted that Paragraph 10(1)(6) draws a distinction between expenditure which falls within the category of 'special expenditure' and that which constitutes 'operating expenses' or 'business expenses'.

II — Main proceedings

6. In 1998, Mr Conijn, a Netherlands national who resides in the Netherlands, derived business income in Germany amounting to DEM 146 373.50 from a shareholding in a German limited partnership which he had inherited as a joint heir. That amount accounted for less than 90% of Mr Conijn's total income.

7. In his 1998 tax return, Mr Conijn claimed the costs of DEM 1 046 which he had incurred in obtaining tax advice for the purpose of preparing that tax return in Germany as 'special expenditure' under Paragraph 10(1)(6) of the EStG 1997.

8. The Finanzamt (Tax Office) Hamburg-Nord (Germany) ('the Finanzamt') refused to allow the deduction of those costs on the basis of the fifth sentence of Paragraph 50(1) of the EStG 1997.

9. Mr Conijn brought an action before the Finanzgericht (Finance Court) Hamburg (Germany) challenging the Finanzamt's decision. That action was dismissed by judgment of 11 November 2003.

10. The applicant in the main proceedings appealed on a point of law to the Bundesfinanzhof (Federal Finance Court) (Germany), asking that court to annul that judgment and to rule that costs incurred in obtaining tax advice are deductible. The Finanzamt contends that the appeal should be dismissed.

III — Reference for a preliminary ruling

11. In its order for reference, the Bundesfinanzhof states that the different treatment of resident and non-resident taxpayers which follows from the abovementioned provisions of the EStG 1997 may infringe the fundamental freedom conferred by Article 52 of the EC Treaty (now, after amendment, Article 43 EC), namely freedom of establishment.

12. Firstly it notes that the Court has, on several occasions, held that residents and non-residents are not, as a general rule, in a comparable situation, and that, therefore, entitlement to deductions linked to the taxpayer's personal circumstances in the

State where the income originates should not compulsorily be extended to non-residents.

13. It also notes that, in the light of the Court's case-law, it is only where the person with restricted tax liability derives almost all of his income in the State where the taxable income originates that the principle of equal treatment requires that tax benefits linked to his personal and family circumstances be extended to him. However, the national court takes the view that that derogation relates directly only to the limited category of tax benefits linked to the personal and family circumstances of the taxpayer and not to 'all living expenses incurred by a private individual'.

14. In that respect, the Bundesfinanzhof comments that the deductibility of costs incurred in obtaining tax advice primarily serves incentive and subsidy purposes which have nothing to do with the personal circumstances of the taxpayer. The taxpayer should receive some compensation for the fact that he had to seek tax advice due to the complexity of tax law, which should take into account the 'unavoidable expenditure' he had to incur, which reduced his income. However, such considerations do not explain why non-residents should be deprived of that tax benefit, at least in so far as the tax advice relates not to the tax return in the taxpayer's State of residence but — solely — to the tax return in the State where the taxable income originates.

15. The national court takes the view that, even assuming that the costs incurred in obtaining tax advice are a living expense, it should be held that having chosen to permit the deduction of such costs, the German legislature should adhere to that decision consistently. Those costs constitute an expense which affects the income of a non-resident as much as that of a resident. Both are equally required to prepare a tax return.

16. For the foregoing reasons, the Bundesfinanzhof had doubts as to whether the German tax legislation applicable in this case was compatible with Community law; it therefore decided to stay proceedings and to refer the following question to the Court for a preliminary ruling:

'Is a situation whereby a national of another Member State with restricted tax liability in Germany, unlike a person with unrestricted tax liability, may not deduct from his total income as special expenditure the costs incurred by him in obtaining tax advice contrary to Article 52 of the Treaty establishing the European Community [now, after amendment, Article 43 EC]?'

IV — Analysis

17. By this question the Bundesfinanzhof is asking in essence whether a situation whereby a national of a Member State with restricted income tax liability in another Member State, in this case Germany, may not deduct from his taxable income costs he has incurred in obtaining tax advice for the purpose of fulfilling his tax obligation in that Member State, while a person with unrestricted tax liability in that Member State is entitled to deduct such costs, is contrary to Article 52 of the Treaty.

18. It should first be pointed out, as the Commission did, that the national court's account of the facts does not make clear in this case the extent of Mr Conijn's shareholding in the German limited partnership.

19. However, such information might be useful in order to establish which articles of the Treaty are applicable in the main proceedings, whether it is those relating to freedom of establishment or those relating to the free movement of capital.

20. Under the second paragraph of Article 52 of the Treaty, '[f]reedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings ... under the conditions laid down for its own nationals by the law of the country where such establishment is effected ...'. As the Court has held, '[s]o, a national of a Member State who has a holding in the capital of a company established in another Member State which gives him definite influence over the company's decisions and allows him to determine its activities is exercising his right of establishment.'[4]

21. However, where this last condition is lacking, the rules on free movement of capital become applicable.

22. In response to any doubts that may arise as to the applicability of Article 52 of the Treaty in the main proceedings, and in the absence of sufficient information on that point in the order for reference, it should be noted that the Court has held that 'in proceedings under Article 234 EC, which is based on a clear separation of functions between the national courts and the Court of Justice, any assessment of the facts in the

4 — Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22. See also, in that regard, Case C-208/00 *Überseering* [2002] ECR I-9919, paragraph 77, and Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 37.

case is a matter for the national court'.[5] Suffice it therefore to note that, in this case, the national court appears to have concluded that Article 52 of the Treaty applies to the dispute before it and that, in the absence of conclusive evidence to support the applicability of rules concerning the free movement of capital, the Court should interpret the rule relied on by that court.

23. Having regard to the Court's interpretation of Article 52 of the Treaty in this case, it will then be for the national court to consider whether Mr Conijn's shareholding in a German limited partnership confers on him definite influence over that company's decisions and enables him to determine its activities. If that was not the case, the national legislation at issue in the main proceedings would be that concerning free movement of capital for the purposes of Article 73b of the EC Treaty (now Article 56 EC), rather than freedom of establishment protected by Article 52 of the Treaty.[6] It should, however, be pointed out that, in the latter situation, the Court's answer to the present question referred for a preliminary ruling would apply also to the field of free movement of capital, in so far as the crux of the issue here, as we will see, is whether or not the German legislation, which does not allow persons with restricted tax liability to deduct costs incurred in obtaining legal advice on a private basis, constitutes discrimination prohibited by Community law.

24. It is now appropriate to answer specifically the question referred for a preliminary ruling by the Bundesfinanzhof.

25. To that end, it is important first to point out that the prohibition on Member States laying down restrictions on the freedom of establishment also applies to tax provisions. According to the Court's settled case-law, even if, in the current state of Community law, direct taxation does not as such fall within the scope of the Community's jurisdiction, Member States must nevertheless exercise their retained powers in compliance with Community law.[7]

26. That means, in particular, that they must 'avoid any overt or covert discrimination on the basis of nationality'.[8] The principle of equal treatment forbids not only overt discrimination by reason of nationality but also all covert forms of discrimination which, by the application of other criteria of

5 — Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 41. See also, in that regard, Case C-326/00 *IKA* [2003] ECR I-1703, paragraph 27, and case-law cited therein.

6 — See, to that effect, Order of the Court in Case C-268/03 *De Baeck* [2004] ECR I-5961, paragraphs 25 and 26

7 — See, in particular, *De Lasteyrie du Saillant*, cited above, paragraph 44, and case-law cited therein.

8 — See, in particular, Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 16, and Case C-385/00 *De Groot* [2002] ECR I-11819, paragraph 75.

differentiation, lead to the same result. [9] Accordingly, the Court has held that a Member State's legislation which grants tax benefits only to persons residing within national territory is liable to operate mainly to the detriment of nationals of other Member States, as non-residents are in the majority of cases foreigners, and therefore such legislation may constitute indirect discrimination by reason of nationality. [10]

27. According to equally settled case-law of the Court, 'discrimination arises through the application of different rules to comparable situations or the application of the same rule to different situations'. [11] In order to ascertain whether or not there is discrimination, the Court traditionally works on the assumption that, 'in relation to direct taxes, the situations of residents and of non-residents are generally not comparable, because the 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 because a non-resident's personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is easier to assess at the place where his personal and financial interests are centred, which in general is the place where he has his usual abode'. [12]

28. It follows 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, from the point of view both of the source of their income and of their personal ability to pay tax or their personal and family circumstances'. [13]

29. Soon after that principle was laid down, however, the Court held, from the time of its judgment in *Schumacker*, cited above, that a non-resident and a resident are not in objectively different situations where 'a non-resident receives no significant income in the State of his residence and obtains the major part of his taxable income from an activity performed in the State of employment, with the result that the State of his residence is not in a position to grant him the benefits resulting from the taking into account of his personal and family circumstances'. [14] The Court takes the view that '[t]

9 — See, in particular, Case 152/73 *Sotgiu* [1974] ECR 153, paragraph 11; Case C-27/91 *Le Manoir* [1991] ECR I-5531, paragraph 10; and Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 26.

10 — See, in particular, *Schumacker*, cited above, paragraphs 28 and 29, and Case C-107/94 *Asscher* [1996] ECR I-3089, paragraph 38.

11 — See, in particular, *Wielockx*, cited above, paragraph 17.

12 — See, in particular, Case C-169/03 *Wallentin* [2004] ECR I-6443, paragraph 15, and case-law cited therein.

13 — Ibid., paragraph 16, and case-law cited therein.

14 — *Schumacker*, cited above, paragraph 36. The Court also accepted in *Wielockx* that 'a non-resident taxpayer, whether employed or self-employed, who receives all or almost all of his income in the State where he works is objectively in the same situation in so far as concerns income tax as a resident of that State who does the same work there' (paragraph 20).

here is no objective difference between the situations of such a non-resident and a resident engaged in comparable [activity], such as to justify different treatment as regards the taking into account for taxation purposes of the taxpayer's personal and family circumstances.'[15]

30. That case-law has been applied a number of times in respect of tax benefits linked to the taking into account of taxpayers' personal and family circumstances, such as mitigation of the progressive nature of the tax scale for married couples,[16] deduction from taxable income of profits invested to form a pension reserve,[17] or even tax allowances on account of personal liabilities such as maintenance payments.[18]

31. Unlike the German Government, I take the view that the *Schumacker* case-law does not apply to the case referred to the Court by the Bundesfinanzhof.

32. Firstly, under that case-law, the criterion for comparability between non-residents and residents with regard to income tax is based on whether non-residents, like residents, receive all or almost all of their taxable income from an activity exercised in the State of taxation. That is not the case, however, for a Member State national, like Mr Conijn, for whom, according to the national court, income received in the State of taxation represents less than 90% of his total income.[19]

33. Secondly, that case-law has, from the outset, been restricted to tax benefits linked to the taking into account of taxpayers' personal and family circumstances. However, I am not of the view that costs incurred in obtaining legal advice can be regarded as falling within that category of tax benefits as they are in no way related to the nature of the taxpayer's personal and family circumstances.

34. In that regard, it is, in my view, of little importance that the tax return prepared with the help of a tax adviser contains certain details concerning the taxpayer's civil status or family circumstances. This does not seem to me to alter the fact that the deductibility of costs incurred in obtaining tax advice is

15 — *Schumacker*, cited above, paragraph 37

16 — *Schumacker*, cited above

17 — *Wielockx*, cited above.

18 — *De Groot*, cited above.

19 — See, in that regard, judgment in Case C-391/97 *Gschwind* [1999] ECR I-5451, in which the Court allowed a Member State to make grant to non-residents of a tax benefit resulting from the taking into account of their personal and family circumstances subject to the condition that at least 90% of their worldwide income must be subject to tax in that State (paragraph 32)

not designed to take into account the personal and family circumstances of the taxpayer.

35. Given my conclusion that the deductibility of such costs does not constitute a tax benefit linked to the taking into account of the personal and family circumstances of a non-resident taxpayer, it is now necessary to determine whether, and how, that kind of tax benefit may be viewed in the light of Community law, and in particular Article 52 of the Treaty.

36. As regards the nature of that tax benefit, the German Government states in its written observations that the costs incurred in obtaining tax advice, categorised under German law as 'special expenditure', constitute 'living expenses' in so far as it is the taxpayer who decides, privately, to contact a tax adviser. [20]

37. The German Government also states that such costs incurred in obtaining tax advice, regarded as private expenses, are to be distinguished from those incurred in a business context. Where such costs are related to a business activity they may be deducted for tax purposes as operating expenses or business costs. That is the case both for natural persons and capital companies, irrespective of whether they have restricted or unrestricted tax liability in Germany. A non-resident taxpayer in Mr Conijn's situation may certainly therefore deduct from his taxable income costs of a business nature incurred in obtaining tax advice. [21]

38. Lastly, the German Government points out that, under German law, living expenses are not, as a rule, tax-deductible. Private expenses may however, in exceptional cases, be deducted from income tax where this is expressly provided for by law and where they represent 'an unavoidable cost which affects ability to pay tax and economic capacity'. The German Government takes the view that that is the case in respect of the costs incurred in obtaining tax advice referred to in Paragraph 10(1)(6) of the EStG 1997. Such costs are regarded as 'special expenditure' for persons with unrestricted tax liability 'since such costs are often made necessary by the complexity of tax law and can therefore

20 — Paragraph 22 of the written observations. As regards that category of expenses, it is necessary to refer to the judgment in Case C-209/01 *Schilling and Fleck-Schilling* [2003] ECR I-13389, which relates to a tax benefit consisting of the deduction of expenditure in respect of domestic help. I would point out, however, that that judgment was set in a specific context, characterised, in particular, by the fact that 'officials and other servants of the European Communities are subject to special rules in matters of taxation that distinguish them from other workers' (paragraph 29).

21 — Paragraph 21 of the written observations.

affect the economic capacity of the taxpayer'. [22]

39. I must admit that those explanations do not convince me that the tax rule at issue is compatible with Community law, and with Article 52 of the Treaty in particular.

40. It is not disputed that, under the EStG 1997, entitlement to deduct as 'special expenditure' costs incurred in obtaining tax advice is a tax benefit reserved only for taxpayers who are resident in Germany. Non-resident taxpayers are therefore, in this respect, placed in a less favourable position than resident taxpayers, which may be a factor in discouraging them from settling in Germany. [23]

41. Is that different treatment of resident and non-resident taxpayers based on an objective difference in situation between those two categories of taxpayer such that it cannot be classified as indirect discrimination on grounds of nationality?

42. I do not think so.

43. I take the view that, as regards the deductibility of costs incurred in obtaining tax advice, resident and non-resident taxpayers are in an objectively comparable situation, and therefore treating them differently in that respect constitutes indirect discrimination on grounds of nationality.

44. In the present case, the comparability between the situations of resident and non-resident taxpayers should, in my opinion, be assessed according to a similar line of reasoning to that adopted by the Court in *Gerritse*. [24]

45. I would point out that, in that judgment, the Court ruled that 'a national provision which, in matters of taxation, refuses to allow

22 — Paragraph 23 of the written observations. The German Government states that that rule relates not only to costs incurred in obtaining advice in respect of the national tax system but also costs incurred in obtaining advice in respect of a foreign tax system. It takes the view that 'foreign tax law is very often just as complex as German tax law' (same paragraph)

23 — It is true that costs incurred in obtaining tax advice may, as in the main proceedings, represent only a small part of the taxable income. However, I would point out that, according to the Court, 'a restriction on freedom of establishment is prohibited by Article 52 of the Treaty even if of limited scope or minor importance' (see, in particular, *De Lasteyrie du Saillant*, cited above, paragraph 43).

24 — Case C-234/01 [2003] ECR I-5933.

non-residents to deduct business expenses, whereas residents are allowed to do so, risks operating mainly to the detriment of nationals of other Member States and therefore constitutes indirect discrimination on grounds of nationality ...'. [25]

46. Before reaching such a finding, however, the Court had to satisfy itself that residents and non-residents were placed in a comparable situation in respect of entitlement to deduct business expenses. In that regard, the Court concluded that 'the business expenses in question are directly linked to the activity that generated the taxable income in Germany, so that residents and non-residents are placed in a comparable situation in that respect'. [26]

47. The criterion for comparability between residents and non-residents is based here on the idea that, in respect of income received for the same business activity pursued in Germany, those two categories of taxpayers are subject in the same way to a reduction of such income in respect of the business expenses they have to pay out which are directly linked to the activity in question. In so far as, in that respect, there is no objective difference between them, treating them differently as regards entitlement to deduct such expenses constitutes indirect discrimination on grounds of nationality.

48. Thus, in parallel with its ruling in *Schumacker*, the Court accepted that, in the case of tax benefits which are not linked to the taking into account of the taxpayer's personal and family circumstances, other criteria may be used for assessing comparability between residents and non-residents.

49. In the present case, I take the view that the comparability between the situations of residents and non-residents stems from the following factors.

50. First, costs incurred by a taxpayer, whether resident or non-resident in Germany, in obtaining tax advice for the purpose of preparing his tax return in that Member State, are linked directly to the taxable income in that Member State, and as such they affect the income received by both categories of taxpayers in the same way.

25 — Ibid., paragraph 28.
26 — Ibid., paragraph 27.

51. Secondly, resident and non-resident taxpayers are, in my view, in a comparable situation in relation to the complexity of tax law.

52. I would point out in that respect that according to the German Government, costs incurred in obtaining tax advice are deductible because they are often made necessary by the complexity of tax law and therefore affect the economic capacity of the taxpayer. The German Government takes the view that it is therefore necessary to 'allow the taxpayer to offset expenses that reduce his income as a result of tax law'. [27]

53. I take the view that the foregoing must also apply to a non-resident taxpayer who, like a resident taxpayer, is required to prepare a tax return and is therefore faced, in a comparable way, with the complexity of tax law.

54. I therefore take the view that, in respect of entitlement to deduct costs incurred in obtaining tax advice as 'special expenditure', resident and non-resident taxpayers are in a comparable situation, first because such costs are linked directly to income taxed in Germany and secondly because, in order to prepare their tax return, both categories of taxpayers are faced with the complexity of tax law.

55. Therefore, the different treatment of resident and non-resident taxpayers which follows from the abovementioned provisions of the EStG 1997, must, in my opinion, be regarded as indirect discrimination on grounds of nationality, which is contrary to Article 52 of the Treaty.

56. Since no justification for that restriction of freedom of establishment has been put forward in the context of the present proceedings, I take the view that the Court should declare that a situation whereby a national of a Member State with restricted income tax liability in another Member State may not deduct from his taxable income costs incurred by him in obtaining tax advice for the purpose of fulfilling his tax obligation in that Member State, while a person with unrestricted tax liability in that Member State is entitled to deduct such costs, is contrary to Article 52 of the Treaty.

27 — Paragraph 29 of its written observations.

V — Conclusion

57. Having regard to all of the foregoing, I propose that the Court give the following answer to the question referred for a preliminary ruling by the Bundesfinanzhof:

'A situation whereby a national of a Member State with restricted income tax liability in another Member State may not deduct from his total income costs incurred by him in obtaining tax advice for the purpose of fulfilling his tax obligation in that Member State, while a person with unrestricted tax liability in that Member State is entitled to deduct such costs, is contrary to Article 52 of the EC Treaty (now, after amendment, Article 43 EC).'