OPINION OF ADVOCATE GENERAL MENGOZZI
delivered on 29 March 2007 [1]

1. By this reference for a preliminary ruling, the Cour administrative (Higher Administrative Court), Luxembourg, is basically asking the Court of Justice to clarify whether a national rule such as that contained in Article 157ter of the Law of 4 December 1967 on income tax, as amended ('the LIR'), is incompatible with the principles relating to the free movement of workers (Article 39 EC). On the basis of Article 157ter of the LIR, for the purposes of determining the rate of tax applicable to income taxable in the Grand Duchy of Luxembourg, account may not be taken of income losses from the letting of properties located in another Member State and belonging to a Community national who, although not resident in the Grand Duchy, receives the major part of his taxable income in that State.

2. The Court has already had occasion to rule on a similar question in *Ritter-Coulais*, in which it assessed the compatibility with Article 39 EC of a provision of German law which did not permit natural persons who received income as employees in Germany and were resident for tax purposes in that country to include, in the calculation of the rate of tax on that income, rental income losses from a house intended for use as a dwelling, which they used personally and was located in another Member State. [2] There are, however, two respects in which the present case differs from *Ritter-Coulais*: firstly, as follows from what I have stated above, unlike the legislation analysed in *Ritter-Coulais*, the Luxembourg legislation at issue does not take into account for the purposes of calculating the rate of tax any positive income which a non-resident obtains from the letting of properties situated outside the country. Secondly, the losses claimed by the applicants in the main proceedings that have given rise to the present reference for a preliminary ruling relate to properties which have been let and they do not occupy themselves.

1 — Original language: Italian.

2 — Case C-152/03 [2006] ECR I-1711.

I — Legislative framework

A — *Relevant Community law*

3. Article 39 EC provides:

'1. Freedom of movement for workers shall be secured within the Community.

2. Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment.

It shall entail the right, subject to limitations justified on grounds of public policy, public security or public health:

(a) to accept offers of employment actually made;

(b) to move freely within the territory of Member States for this purpose;

(c) to stay in a Member State for the purpose of employment in accordance with the provisions governing the employment of nationals of that State laid down by law, regulation or administrative action;

(d) to remain in the territory of a Member State after having been employed in that State, subject to conditions which shall be embodied in implementing regulations to be drawn up by the Commission.'

B — *National law*

4. The rules concerning the taxation of natural persons which are material in this case are largely contained in the abovementioned LIR and in the Convention for the avoidance of double taxation and the establishment of rules relating to mutual administrative assistance in the fields of income tax, wealth tax, local business tax and property tax, concluded on 23 August 1958 between the Grand Duchy of Luxembourg and the Federal Republic of Germany ('the DTC').

5. In particular, Article 157ter of the LIR provides that taxpayers who are not resident in Luxembourg but are taxable there with

respect to at least 90% of their total local and foreign earned income are, on application, to be taxed in Luxembourg, on the element of their income which is taxable in that country, at a rate of tax that is determined taking account of the rate that would apply were they resident, with their local income in Luxembourg and their foreign *earned* income being taken into consideration for that purpose. [3]

6. It is, however, clear from the documents before the Court that, in determining the rate of tax applicable to the taxable income of a taxpayer resident in Luxembourg, his overall ability to pay tax will be taken into account, including any losses relating to the letting of properties situated abroad (Article 134 of the LIR).

7. In accordance with Article 4 of the DTC, income deriving from the letting of property is taxable in the Contracting State in which that property is situated.

8. Again according to the DTC, the State of residence is required to take account of the worldwide income of its taxpayers for the purpose of determining the rate of tax applicable to income which is taxable in that State (Article 24).

II — The facts, the question referred and the procedure before the Court

9. Mr Lakebrink and Mrs Peters-Lakebrink ('Mr and Mrs Lakebrink') are both German nationals resident in Germany. For the 2002 tax year, their taxable income consisted of income from employment in Luxembourg, and they applied for joint tax assessment in Luxembourg for that year pursuant to Article 157ter of the LIR.

10. Consequently, they were taxed on their taxable income in Luxembourg at the rate of tax which would have applied to them had they been resident in Luxembourg. The relevant tax notices stated, furthermore, that in determining that rate of tax, pursuant to Article 157ter of the LIR, income losses from the letting of property situated in Germany had not been taken into account, although Mr and Mrs Lakebrink had requested this.

3 — It is apparent from the order for reference that, by means of the arrangements described above and contained in Article 157ter of the LIR, the Luxembourg legislature intended to comply with Community rules and, more particularly, the principles which the Court laid down in Case C-279/93 *Schumacker* [1995] ECR I-225, in which it supposedly restricted the equal treatment which the free movement of workers implies exclusively to economic activities which generate earned income.

11. Mr and Mrs Lakebrink contested that decision, lodging two objections challenging the income tax notices with the director of the direct taxation authority.

12. When the administrative authorities failed to acknowledge their objections, Mr and Mrs Lakebrink referred the matter to the Tribunal administratif (Administrative Court), Luxembourg, which joined the two actions brought and declared them to be admissible and well founded in so far as they sought rectification of the tax notices, stating that, for the purpose of calculating the tax rate applicable to the applicants' income, account should be taken of the rental losses relating to property situated in Germany as determined by the German tax authorities.

13. The État du Grand-Duché de Luxembourg (State of the Grand Duchy of Luxembourg), represented by its Minister of Finance, lodged an appeal against this decision with the Cour administrative which, being uncertain as to the interpretation of Article 39 EC, decided to stay the proceedings pending before it and to refer the following question to the Court for a preliminary ruling:

'Is Article 39 EC to be interpreted as precluding national rules, such as those introduced in the Grand Duchy of Luxembourg by Article 157ter of the [LIR], under which a Community national not resident in Luxembourg who receives income of Luxembourg origin from employment, which constitutes the major part of his taxable income, cannot rely on his negative rental income relating to property situated in another Member State, in this case Germany, which he does not himself occupy, for the purposes of the determination of the tax rate applicable to his Luxembourg income?'

14. Pursuant to Article 23 of the Statute of the Court of Justice, written observations were submitted by Mr and Mrs Lakebrink, the Commission and the Luxembourg, Swedish and Netherlands Governments.

III — Legal analysis

A — *The existence of indirect discrimination*

15. By its question, the national court is basically asking whether Article 39 EC must be interpreted as precluding national rules under which, in determining the rate of tax applicable to the taxable income in the Grand Duchy of Luxembourg of a Community national who is not resident in Luxem-

bourg but receives there the major part of his taxable income in the form of income from employment, rental losses relating to property situated in another Member State are not taken into account, whereas negative income of that nature is relevant for the purpose of taxing residents.

16. The Luxembourg, Swedish and Netherlands Governments consider that the question should be answered in the negative, while Mr and Mrs Lakebrink and the Commission take the opposite view.

17. Bearing in mind that the rule at issue concerns the taxation of natural persons, it is necessary to analyse it from the perspective that — according to the Court's settled case-law — although, as Community law stands at present, direct taxation as such does not fall within the purview of the Community, the Member States must none the less exercise their powers in this area consistently with Community law, in particular with the fundamental freedoms on which the establishment and operation of the internal market are based.[4]

18. Given that the applicants in the main proceedings engage in *employed activity* in a Member State, the national legislation at issue must, clearly, be analysed with reference to Article 39 EC.

19. Article 39 lays down the principle of freedom of movement for workers and requires the abolition of all discrimination based on nationality between workers of the Member States.[5]

20. I would, however, point out that the rule at issue in the main proceedings applies irrespective of the nationality of the taxpayer concerned. None the less, a difference in treatment which is based on residence or place of origin may, in certain circumstances, produce an outcome that is equivalent to discrimination based on nationality.

21. In accordance with the Court's settled case-law, not only discrimination by reason of nationality is prohibited but also all forms of discrimination which, by the application of other criteria of differentiation, lead in fact to

4 — See, in particular, *Schumacker*, paragraph 21; Case C-246/89 *Commission* v *United Kingdom* [1991] ECR I-4585, paragraph 12; and Case C-209/01 *Schilling and Fleck Schilling* [2003] ECR I-13389, paragraph 22.

5 — See, inter alia, Case C-419/92 *Scholz* [1994] ECR I-505, paragraph 7.

the same result, discrimination being understood as the application of different rules to comparable situations or the application of the same rule to different situations. [6]

22. In relation to direct taxes, the Court has held that a difference in treatment based on residence is not of itself discriminatory because, in principle, that criterion is indicative of a link between the taxpayer and his country of origin and could, therefore, justify different tax treatment. [7]

23. In that connection, the Court has explained that the situations of residents and 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. [8]

24. Consequently, 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. [9]

25. The Court has, however, stated that the position is different where the 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. [10] In the case of a non-resident who receives the major part of his income in a Member State other than that of his residence, discrimination arises

6 — See, inter alia, Case 152/73 *Sotgiu* [1974] ECR 153, paragraph 11, and Case C-27/91 *Le Manoir* [1991] ECR I-5531, paragraph 10.

7 — See *Schumacker*, paragraphs 31 to 34; Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 18; Case C-107/94 *Asscher* [1996] ECR I-3089, paragraph 41; and Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, paragraph 27.

8 — See *Schumacker*, paragraphs 31 and 32; Case C-391/97 *Gschwind* [1999] ECR I-5451, paragraph 22; Case C-87/99 *Zurstrassen* [2000] ECR I-3337, paragraph 21; and Case C-234/01 *Gerritse* [2003] ECR I-5933, paragraph 43.

9 — See *Schumacker*, paragraph 34; *Gschwind*, paragraph 23; and *Gerritse*, paragraph 44.

10 — See *Schumacker*, paragraph 36, and Case C-385/00 *de Groot* [2002] ECR I-11819, paragraph 89.

from the fact that his personal and family circumstances are taken into account neither in the State of residence nor in the State of employment. [11]

26. If, in the light of all of the above considerations, we turn now to the instance that forms the subject-matter of the question which has been referred, there can, in my view, be no doubt that, in circumstances such as those at issue here, application of the rule in question amounts to a difference in treatment in relation to Mr and Mrs Lakebrink, based on the fact that their place of residence lies outside Luxembourg territory.

27. As I mentioned above, for the purpose of determining the rate applicable to residents' taxable income, Luxembourg legislation takes account of their worldwide income. However, a taxpayer who is not resident in Luxembourg for tax purposes, but receives in Luxembourg all or virtually all of his taxable income, is treated like a resident taxpayer only to a certain extent since, apart from income of Luxembourg origin, the progressive tax rule — which is used in calculating the rate of tax — applies only to foreign earned income of a non-resident and not, therefore, to income which does not fall into that category, including, as in this case, income from the letting of property.

28. It follows that, in circumstances such as those of the present case, the failure to take into account losses from the letting of property situated abroad when calculating the rate of tax applicable to a taxpayer who, although not resident in Luxembourg, receives all or virtually all of his taxable income in that State certainly constitutes disadvantageous treatment of that taxpayer as compared with the treatment accorded to a resident taxpayer who engages in a similar activity and will be able to have losses of that nature included in the calculation of his rate of tax.

29. Nor is that conclusion contradicted, as the Luxembourg and Netherlands Governments contend, by the fact that, for the purposes of calculating the rate of tax under Article 157ter of the LIR, the Luxembourg legislation does not take account of any positive income of non-residents from the letting of property abroad. Any advantage that non-resident taxpayers may enjoy as compared with resident taxpayers in a similar situation is not sufficient to offset the disadvantage which they suffer in a case, such as the present one, in which neither the State of residence — because of the lack of taxable income in that State — nor the State of employment takes into account rental losses in respect of property situated abroad. To take the view that, because a disadvantage is not systematic, it is not liable to result in discrimination would be tantamount to

11 — *Schumacker*, paragraph 38.

regarding as compatible with the principle of freedom of movement for workers a tax regime which is only occasionally unfavourable to non-resident taxpayers, on the assumption that, being merely occasional, the disadvantage is of little significance. That would lead to minor forms of discrimination being tolerated, thereby rendering the general prohibition under Article 39 EC meaningless. [12]

30. Having established that the rule at issue results in differential treatment to the disadvantage of non-residents, it is now necessary to ascertain whether such a difference in treatment is actually discriminatory, that is to say whether the situation of residents and non-residents is objectively comparable as regards that rule.

31. Given that, in this case, both Mr and Mrs Lakebrink receive all of their taxable income in their State of employment — namely Luxembourg — and do not receive significant income in their State of residence, I consider that they are in a situation comparable to that of a resident of the Grand Duchy of Luxembourg for the purposes of the rules governing calculation of the rate of tax.

32. That, in my view, is the purport of the Court's case-law, according to which — even though, with regard to direct taxation, generally the situation of a resident is different from that of a non-resident in so far as the major part of his income is normally concentrated in the State of residence, and that State generally has available all the information needed to assess the taxpayer's overall ability to pay — there ceases to be any objective difference between the two situations such as to justify different treatment as compared with resident taxpayers where the non-resident receives no significant income in the Member State of residence and obtains the major part of his taxable income from an activity performed in the State of employment. [13]

33. Although the Court has specifically ruled to that effect on taxation systems so far as concerns the taking into account of a non-resident taxpayer's personal and family circumstances, stating that '[t]here is no objective difference ... such as to justify different treatment as regards the taking into account for taxation purposes of the tax-

12 — See, in a similar vein, *de Groot*, paragraph 97, and, with regard to the freedom of establishment, Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 43.

13 — See *Schumacker*, paragraphs 36 and 37.

payer's *personal and family circumstances*', [14] it is not, however, stated that the Court intended to confine solely to those aspects of the overall ability to pay the equation of a non-resident taxpayer who receives all or virtually all of his income in the State of employment with a taxpayer resident in that State and engaged in comparable employed activity there.

34. It is necessary to assess the conclusion which the Court has reached — concerning whether residents and non-residents can be treated as equivalent — in the light of the reason on which that conclusion is based, in order to determine whether equivalence of that nature may be considered to exist in the present case also, in which a tax benefit unconnected with the non-resident taxpayer's personal and family circumstances is being denied. [15]

35. The Court has reasoned that a non-resident taxpayer is, generally, in an objectively different situation compared with a resident of the State of employment because he receives only part of his income in that State and could, therefore, in theory enjoy the tax benefits pertaining to his personal taxation position twice over, that is to say both in the State of residence and in the State of employment. In the case of such circumstances, where the situations of residents and non-residents are not objectively comparable, the Court has ruled that if the State of employment denies tax benefits linked to the personal tax position of a non-resident this does not constitute discriminatory treatment of the latter.

36. However, if the non-resident receives all or virtually all of his taxable income in the State of employment, there is no longer a risk that he will enjoy the benefits linked to his personal tax position twice over — the State of residence will not be able to take account of his personal tax position because he does not receive significant income there — and, consequently, there ceases to be any difference as compared with the situation of a resident taxpayer. The corollary of this is that proper application of the principle of non-discrimination — of which the case-law analysed above is an illustration — requires the State of employment to treat a non-resident all or virtually all of whose income is generated in its territory in the same way as a resident, not only as regards the grant of tax benefits linked to the non-resident's *personal and family* circumstances, but also in relation to any aspect of his overall ability to pay which is relevant for according tax benefits to residents.

14 — Ibid., paragraph 37. Emphasis added.

15 — See, to that effect, the Opinion of Advocate General Léger in *Ritter-Coulais*, point 91 et seq.

37. Turning now to the substance of the question, it is clear from my analysis so far that, since Mr and Mrs Lakebrink do not receive substantial income in their State of residence, they are fully liable for tax in their State of employment — Luxembourg — which will have to accord them the tax benefits linked to the overall ability to pay that it grants its own residents, because their situation is objectively comparable to that of residents. It follows that Mr and Mrs Lakebrink are suffering indirect discrimination as a result of the application of Article 157ter of the LIR, in so far as one aspect of their ability to pay tax — namely the losses from the letting of property — is not being taken into account in Luxembourg in the computation of their rate of tax, on the ground that their place of residence is outside Luxembourg territory.

38. I should make it clear that, contrary to what the Netherlands and Swedish Governments claim, this solution is without prejudice to the freedom to allocate the power of taxation among the Member States, as upheld by the Court on several occasions.

39. Above all, the difference in treatment which I have established at point 37 above results solely from the application of Luxembourg's national law — Article 157ter of the LIR — while the DTC between Germany and Luxembourg is not in any way called in question. [16]

40. Also, the rule at issue does not relate to the manner in which the basis of assessment is determined, but to the recognition of one aspect of the non-resident's ability to pay tax, *solely for the purpose of calculating the rate of tax* and not also for the purpose of determining the basis of assessment. Consequently, establishing that the State of employment should, exceptionally, when determining the rate of tax, grant the tax benefits linked to the non-resident's overall ability to pay tax, including any benefits linked to the management of assets where the State of employment does not have the power to tax the income from such assets, does not imply that the latter State is taxing that income. It follows that, in this case, the allocation of fiscal powers on a territorial basis for which the DTC between Germany and Luxembourg provides remains unaffected since, in taxing a taxpayer who is not resident in Luxembourg but is fully liable for tax in that country, the Grand Duchy of Luxembourg will not be required to include in the basis of assessment income from the letting of property situated in Germany — for the taxation of which jurisdiction remains with Germany — but will, exceptionally, have

16 — That difference derives from the rules of just one legal order and does not result from disparities or the allocation of powers of taxation between two Member States.

to take it into account in determining the rate of tax.

41. Finally, as regards the method by which a non-resident taxpayer's overall ability to pay is to be taken into account where he receives all or virtually all of his taxable income in the State of employment, it is my view that Community law lays down no specific requirement, provided that that the taxpayer in question is not discriminated against as compared with a resident who, being engaged in a similar activity, is in an objectively comparable situation. [17]

42. With reference to the present case, it therefore follows that, in order for a non-resident's income from letting abroad to be taken into account in the computation of the rate of tax, that income must be determined subject to the same conditions as apply to taxpayers who are resident in the Grand Duchy and, consequently, pursuant to the provisions of Luxembourg tax legislation, German law being without any relevance in that regard. [18] In my view, this approach is not invalidated — contrary to the judgment delivered at first instance in the main proceedings and to the view the Luxembourg Government has expressed — by the fact that the power to tax the income in question lies with Germany under the DTC. As we have seen above, the determination of that income is relevant only to enable it to be taken into consideration by the State of employment when calculating the rate of tax and not for the actual taxation of the income, as Germany still has jurisdiction over this, and if positive income is generated this will be taxed on the basis of the German rules.

B — *Possible justifications*

43. Given that the rule at issue restricts exercise of freedom of movement by workers, it is necessary to ascertain whether it might be justified in the light of Community law.

44. Although the Luxembourg Government does not formally cite any justification for the difference in treatment deriving from the rule at issue, it is basically seeking, in the observations which it has submitted, to demonstrate that the rationale underlying the contested rule is the need to safeguard

17 — For a similar line of reasoning, see *de Groot*, cited above, paragraphs 114 and 115.

18 — Articles 134 and 134ter of the LIR.

the coherence of its own tax system. Consequently, I shall consider that ground of justification as a subsidiary issue only.

1. Safeguarding the coherence of the tax system

45. The Luxembourg Government basically points to the existence of a form of 'coherence' underlying the rule at issue which, while precluding the taking into consideration of rental income losses for non-residents — for the purpose of determining both the basis of assessment and the rate of tax — in parallel does not take into account any positive income of that nature.

46. Preserving the coherence of the national taxation system is a concept established in case-law since the judgments in *Bachmann* and *Commission* v *Belgium*, where the Court recognised, in principle, that this was an overriding reason in the public interest that could justify a restriction on the fundamental principles relating to freedom of movement. [19]

19 — Case C-204/90 *Bachmann* [1992] ECR I-249, paragraphs 21 to 28, and Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305, paragraphs 14 to 21.

47. In the abovementioned cases, the Court justified, on the basis of the coherence of the tax system, national rules which made the deductibility of contributions to pension and life assurance policies subject to the condition that those contributions were made in the State which allowed the deduction. That restriction was justified by the need to compensate for the loss in tax revenue consequent upon the deduction of the contributions paid under insurance policies by taxing the sums received under those policies, sums which could not, however, have been taxed in the case of insurance companies established abroad.

48. Since those judgments, preserving the coherence of the tax system has been the justification most frequently relied upon in relation to direct taxes of the Member States. However, the Court has substantially restricted the concept of tax coherence and, in settled case-law, has stated that this requirement justifies a measure restricting the fundamental freedoms if three separate conditions are met: (a) there must be a direct link between the granting of a tax benefit and the offsetting of that benefit by a tax charge; (b) the deduction and the charge must arise

in relation to the same tax; and (c) they must be applied to the same taxpayer. [20]

49. Since the two conditions relating to the taxpayer being the same and the tax being the same are certainly met in this case, it is now necessary to establish whether there is a direct link between the deduction of the rental losses and the taking into account of increased income from investment of that type when determining the rate of tax.

50. The rule at issue is founded on a rule of symmetry, under which neither foreign rental losses nor any positive income from such investment in property are material for the purposes of calculating a non-resident's rate of tax. It follows that taking into consideration rental losses alone would undermine the rationale of the rule at issue, since that benefit when calculating the rate could not be offset by the taking into account, for the same purpose, of any positive income which a property investment of that nature would probably generate in future.

51. While failing to take into account foreign rental losses in calculating a non-resident's rate of tax may therefore, in principle, be justified by the need to protect the coherence of Luxembourg's tax system, it will none the less be for the national court to ascertain whether that restrictive measure is applied in such a way as to respect the principle of proportionality. The measure at issue must be appropriate for ensuring attainment of the object it pursues and not go beyond what is necessary for that purpose. [21]

52. However, the rule at issue does not appear to constitute the least restrictive measure capable of preserving the coherence of Luxembourg's tax system, since that objective could also be secured, while achieving the same compensatory effect, by including in the calculation of the rate of tax for non-residents both negative and positive income from letting abroad. A system of that nature would make it possible to avoid situations, such as the one here, in which certain aspects of a taxpayer's ability to pay are not taken into consideration, either in the State of residence — because no significant income is received there — or in the State of employment, where that taxpayer receives the major part of his income.

20 — Without entering into greater detail here in relation to the recent developments in case-law concerning the concept of 'tax coherence', since it is not relevant to this case, I would, however, point out that the Court has recently applied the conditions underlying that principle in a flexible manner, stressing the teleological aspect of the tax system at issue. See, in that regard, my Opinion in Case C-298/05 *Columbus*, point 189 et seq.

21 — See, inter alia, Case C-19/92 *Kraus* [1993] ECR I-1663, paragraph 32.

IV — Conclusion

53. In the light of the considerations set out above, I propose that the Court reply as follows to the Cour administrative, Luxembourg:

Article 39 EC must be interpreted as precluding rules of a Member State, such as Article 157ter of the LIR, under which a Community national not resident in Luxembourg who receives income of Luxembourg origin from employment, which constitutes the major part of his taxable income, cannot — unlike a Luxembourg resident — rely on negative rental income relating to property in another Member State, which he does not himself occupy, for the purposes of the determination of the tax rate applicable to his Luxembourg income.