OPINION OF ADVOCATE GENERAL
KOKOTT
delivered on 10 September 2009 [1]

I — Introduction

1. If a company grants an unusual or gratuitous advantage to a company with which it has a relationship of interdependence, this may have an effect on the tax base of the companies concerned. The company which grants the advantage may reduce its income or deduct the relevant amount as an operating expense, thus lessening its tax burden. On the other hand, the payment is likely to expand the tax base of the recipient company.

2. If the companies involved in the transaction are established in different Member States, the grant of an unusual or gratuitous advantage may therefore result in a shift of the tax base from one State to another.

3. The Belgian legislation applied in the main proceedings counteracts that effect. Operating on the basis of the arm's-length principle, it makes an adjustment, for tax purposes, in respect of the grant of such advantages between companies having a relationship of interdependence, especially when the beneficiary company is established abroad. The Tribunal de première instance de Mons (Court of First Instance, Mons (Belgium)) therefore wishes to verify whether such a provision is compatible with the freedom of establishment and the free movement of capital.

4. In that context, it must be ascertained whether any restriction on the fundamental freedoms is justified. In that connection, the Member States submitting observations and the Commission make reference to the safeguarding of a balanced allocation of the power to tax between Member States and the need to combat abusive practices. Thus, the present case presents an opportunity to examine more closely the relationship between those grounds of justification.

1 — Original language: German.

II — Legal framework

A — *OECD Model Convention*

5. Article 9 of the model convention drawn up by the Organisation for Economic Co-operation and Development (OECD) on the avoidance of double taxation in the field of taxation of income formulates the arm's-length principle as follows:

'(1) Where

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

(2) Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.'

B — *Arbitration convention between the Member States*

6. The Member States of the European Community took Article 9 of the OECD Model Convention as the model for the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC) of 23 July 1990 [2] ('the Arbitration Convention'). All of the Member States concluded that convention, based on Article 220 EEC (subsequently Article 220 EC, now Article 293 EC), or have acceded thereto. [3]

7. Article 4(1) of the Arbitration Convention corresponds on a word-for-word basis with Article 9(1) of the OECD Model Convention. If an adjustment of profits effected in accordance with Article 4 of the Arbitration Convention results in double taxation, on application by the relevant enterprise, a procedure aimed at reaching mutual agreement and, where necessary, an arbitration procedure must be implemented between the tax authorities of the Member States concerned (Article 6 and Article 7 of the Arbitration Convention).

2 — OJ 1990 L 225, p. 10.

3 — See, most recently, on the accession of Bulgaria and Romania: Article 3 of the Act concerning the conditions of accession of the Republic of Bulgaria and Romania and the adjustments to the Treaties on which the European Union is founded (OJ 2005 L 157, p. 203), in conjunction with Council Decision 2008/492/EC of 23 June 2008 concerning the accession of Bulgaria and Romania to the Convention of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (OJ 2008 L 174, p. 1) and Council Decision 2008/493/EC of 23 June 2008 amending Annex I to the Act of Accession of Bulgaria and Romania (OJ 2008 L 174, p. 6).

C — *Belgian law*

8. Article 26 of the Code des impôts sur les revenus 1992 (Income Tax Code of 1992) ('the CIR 92') is worded as follows:

'Subject to the provisions of Article 54, where an undertaking established in Belgium grants unusual or gratuitous advantages, those advantages shall be added to its own profits unless they are used in order to determine the taxable income of the recipients.

Notwithstanding the restriction laid down in the first paragraph, there shall be added to the undertaking's own profits unusual or gratuitous advantages which it grants to:

1. a taxpayer referred to in Article 227 with which the undertaking established in Belgium is, directly or indirectly, in some form of relationship of interdependence;

2. a taxpayer referred to in Article 227 or a foreign establishment which, under the legislation of the country in which it is established, is not subject to income tax in that country or is subject to a tax system there which is markedly more favourable than the tax system to which the undertaking established in Belgium is subject;

3. a taxpayer referred to in Article 227 which has common interests with the taxpayer or establishment referred to in subparagraph 1.'

9. According to national case-law, an advantage is regarded as unusual if it is contrary to the normal course of events or established business rules and practice, in the light of the prevailing circumstances. A gratuitous advantage is one which is conferred in the absence of any corresponding obligation or consideration. [4]

10. Article 227 of the CIR 92 defines non-residents as follows:

'2. Foreign companies … which do not have their registered office, principal place of business or centre of management or administration in Belgium.'

11. Article 49(1) of the CIR 92 is worded as follows:

'Expenses shall be regarded as deductible business expenses if they have been incurred or borne by a taxpayer during the tax period for the purposes of generating or retaining taxable income and the authenticity and amount of those expenses is demonstrated by documentary evidence or, where that is not possible, by any other form of evidence admitted under general law, other than by oath.

Expenses shall be treated as incurred or borne during the tax period if, during such period, they were actually paid or borne or they acquired the characteristics of proven and established debts or losses and are accounted for as such.'

12. Article 79 of the CIR 92 restricts the deduction of losses by the beneficiary of an unusual or gratuitous advantage:

'Business losses may not be deducted from any portion of earnings or profit which derives from unusual or gratuitous advantages obtained by the taxpayer, directly or indirectly, in whatsoever form and by whatsoever

4 — See the judgment of the Cour constitutionnelle de Belgique (Belgian Constitutional Court) of 6 November 2008 (No 151/2008, *Moniteur Belge* of 4 December 2008, p. 63824, B.4.2.) and of the Cour de cassation belge (Belgian Court of Cassation) of 10 April 2000, Arrêts de la Cour de Cassation 2000, 240, Pasicrisie Belge 2000, I, 240.

means, from an undertaking with which, directly or indirectly it has a relationship of interdependence.'

13. In addition, Article 207 of the CIR 92 excludes further deductions from income deriving from unusual or gratuitous advantages.

III — Facts and the questions referred

14. Société de Gestion Industrielle (SGI) is a holding company incorporated under Belgian law operating in the metals industry. It has a 65% shareholding in the French company Recydem and is a director of that undertaking. Cobelpin, a Luxembourg company, is a member of the board of directors of SGI and one of its managing directors (administrateurs délégués). In addition, Cobelpin has a 34% shareholding in SGI. A further managing director of SGI is Mr Domenico Leone. He is a director of both Cobelpin and Recydem.

15. As a result of an inspection on 13 October 2003, the Belgian tax authorities issued SGI with two revised assessments for the tax years 2001 and 2002. In addition to other reassessments, the profits of SGI were increased by BEF 1 891 806 (EUR 46 897), in accordance with Article 26 of the CIR 92. That corresponds to interest of 5% per annum on the sum of BEF 37 836 113 which SGI had granted to Recydem as an interest-free loan.

16. In the view of the referring court, the authorities correctly applied Article 26 of the CIR 92 by adding on the interest. Moreover, in the court's view, no economic justification exists for the grant of an interest-free loan by SGI to Recydem. Whereas, in the period in question, Recydem was in a financially secure position and generated profits, SGI was subject to a severe financial burden as a result of granting loans.

17. In addition, the tax authorities refused to grant a deduction for the monthly remuneration of LUF 350 000 (EUR 8 676) paid to Cobelpin for its services as director of SGI. According to the authorities, those payments did not satisfy the conditions for deductibility under Article 49 of the CIR 92 as they were clearly disproportionate and unrelated to the economic benefit of the services in question. Cobelpin was represented as director by none other than Philippe Brilot, already a director of SGI in his own name. In the view of the authorities, the arrangement constituted a loss-making transaction, undertaken solely with the aim of avoiding tax.

18. Nor does the referring court consider the remuneration to constitute business expenses deductible under Article 49 of the CIR 92. In its view, the unusual advantages granted by SGI to Cobelpin are not tax-exempt and must be added to SGI's own profits, pursuant to Article 26 of the CIR 92.

19. Following an administrative appeal, SGI brought an action challenging the tax assessments before the Tribunal de première instance de Mons. By order of 19 June 2007, that court made a reference to the Court of Justice for a preliminary ruling on the following questions:

'1. Does Article 43 EC, in conjunction with Article 48 EC and, if appropriate, Article 12 EC, preclude legislation of a Member State which, like that at issue, gives rise to the taxation of a company resident in Belgium in respect of an unusual or gratuitous advantage which it has granted to a company established in another Member State with which the Belgian company has, directly or indirectly, a relationship of interdependence, whereas, in identical circumstances, the company resident in Belgium cannot be taxed in respect of an unusual or gratuitous advantage where that advantage is granted to another company established in Belgium with which the Belgian company has, directly or indirectly, a relationship of interdependence?

2. Does Article 56 EC, in conjunction with Article 48 EC and, if appropriate, Article 12 EC, preclude legislation of a Member State which, like that at issue, gives rise to the taxation of a company resident in Belgium in respect of an unusual or gratuitous advantage which it has granted to a company established in another Member State with which the Belgian company has, directly or indirectly, a relationship of interdependence, whereas, in identical circumstances, the company resident in Belgium cannot be taxed in respect of an unusual or gratuitous advantage where that advantage is granted to another company established in Belgium with which the Belgian company has, directly or indirectly, a relationship of interdependence?'

20. In the proceedings before the Court, SGI, the Belgian, German and Swedish Governments and the Commission of the European Communities submitted written and oral observations.

IV — Legal appraisal

21. By its two questions, the referring court wishes, in essence, to ascertain whether a national provision such as Article 26 of the CIR 92 is compatible with the freedom of establishment provided for by Article 43 EC

and the free movement of capital guaranteed by Article 56 EC and, if appropriate, in conjunction with Article 12 EC.

22. However, before proceeding to consider those questions, I wish to make a brief observation on the national provisions applicable in the main proceedings.

23. In the view of the referring court, Article 26 of the CIR 92 constitutes the basis for the addition of loan interest not claimed in the income of SGI and for the 'reintegration' in its income of the excessive remuneration paid for directors' services. However, it is evident from the order for reference that the tax authorities clearly did not apply Article 26 of the CIR 92 to the remuneration paid by SGI to Cobelpin for its services as director. Instead, they refused the deduction of those payments as constituting operating expenditure on the basis of Article 49 of the CIR 92.

24. The Belgian Government indicates that in Belgian case-law and academic literature the relationship between the two provisions is contested. However, in response to a question of the Court, it refers to a recent judgment of the Belgian Constitutional Court. According to that judgment, both provisions apply independently of each other. [5]

25. Although the Tribunal de première instance de Mons shares the view that the remuneration in question is wholly excessive and, accordingly, cannot be deducted as operating expenditure under Article 49 of the CIR 92, it seeks an interpretation of the fundamental freedoms only as regards Article 26 of the CIR 92. Consequently, for the present purposes, it is unnecessary to consider any bearing that Article 49 of the CIR 92 may also have on the outcome of the dispute in the main proceedings. [6]

A — *Fundamental freedom applicable*

26. As an initial matter, it must be ascertained whether, in the present case, both the freedom of establishment and the free movement of capital are applicable and, if so, which of the two should be the focus of the examination.

5 — Judgment of 6 November 2008, cited in footnote 4, B.10.3 and B.10.4. However, that judgment relates to a recast version of Article 26 of the CIR 92, in force since 1 January 2008. It expressly states that that provision applies 'without prejudice to the application of Article 49'.

6 — It should noted simply in passing that, unlike Article 26, Article 49 of the CIR 92 does not lay down different rules according to whether the transaction in question is domestic or cross-border.

27. As Article 43 EC and Article 56 EC constitute specific expressions of the general prohibition of discrimination on grounds of nationality, additional recourse to Article 12 EC is, however, unnecessary. [7]

28. According to established case-law, in order to ascertain whether national legislation falls within the scope of one or another of the freedoms of movement, primary consideration must be given to the purpose of the legislation concerned. [8]

29. If the national legislation concerns shareholdings which give their owner a definite influence over the company's decisions, allowing it to determine its activities, freedom of establishment takes precedence. [9] However, the Court has not established a holding threshold of general application which must be reached in order for a determining influence to be presumed. [10]

30. At the same time, the Court has categorised as falling 'primarily' within the scope of the freedom of establishment legislation simply concerning relationships within a group of companies. [11] However, even in that context, the Court has not defined the conditions which must be satisfied for several companies to be regarded as constituting a group.

31. Subparagraph 1 of the second paragraph of Article 26 of the CIR 92 applies to advantages which one company confers on another company with which it has, directly or indirectly, a relationship of interdependence. For the purposes of that provision — as was indicated by the Belgian Government at the Court's request — a relationship of interdependence may, but must not necessarily, arise as a result of a holding of a particular size. On the other hand, according to those indications, a relationship of interdependence may exist, for example, because of financial relations or because of a dependence as regards particular raw materials or technology.

7 — See, that effect, see Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraphs 38 and 39; Case C-443/06 *Hollmann* [2007] ECR I-8491, paragraphs 28 and 29; and Case C-105/07 *Lammers & Van Cleeff* [2008] ECR I-173, paragraph 14.

8 — Summarising the position, see: Case C-157/05 *Holböck* [2007] ECR I-4051, paragraph 22, which refers to Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraphs 31 to 33; Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paragraphs 37 and 38; Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, paragraph 36; and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paragraphs 26 to 34.

9 — See Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 21; Case C-231/05 *Oy AA* [2007] ECR I-6373, paragraph 20; Case C-360/06 *Heinrich Bauer Verlag* [2008] ECR I-7333, paragraph 27; and Case C-282/07 *Truck Center* [2008] ECR I-10767, paragraph 25.

10 — Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225, p. 6), in the version in Directive 2003/123/EC of 22 December 2003 (OJ 2004 L 7, p. 41), has been applicable since 1 January 2009 once a holding reaches 10%.

11 — *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited in footnote 8, paragraph 32; *Oy AA*, cited in footnote 9, paragraph 23; and *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 33.

32. In those circumstances, it must be assumed that the national legislation at issue covers, essentially, situations falling within the scope of the freedom of establishment. An undertaking is likely, in fact, to grant unusual or gratuitous advantages to another undertaking when the undertaking itself or its shareholders indirectly profit from that transaction, for example, because this reduces the overall tax burden on the group of companies.

33. However, the possibility cannot be excluded that other fundamental freedoms are also relevant. Thus, the free movement of goods or capital or the freedom to provide services might be affected if an advantage — not constituting specific consideration in the framework of a particular transaction — is granted on grounds of a particular interest in certain supplies of goods, financial transactions or other services.

34. Therefore, as Article 26 of the CIR 92 does not necessarily govern simply cases in which a taxpayer exercises its right to freedom of establishment, I shall go on to examine how the facts of the main proceedings may be specifically categorised.

35. In that regard, it must be concluded that both Cobelpin's holding in SGI and SGI's holding in Recydem are of a magnitude which allows the respective shareholders to have a decisive influence on the companies in question. In addition, Cobelpin is a director of SGI and in that capacity also has a decisive influence on the management of that undertaking. As both undertakings associated with SGI are established, moreover, in Member States other than the State of SGI's establishment — Recydem in France and Cobelpin in Luxembourg — the facts of the case must be examined primarily in the light of Article 43 EC in conjunction with Article 48 EC.

36. In the present case, it is therefore unnecessary to determine whether, in a situation such as that at issue here, the free movement of capital or, possibly, other fundamental freedoms apply, in addition to the freedom of establishment. [12]

37. If the true nature of the competitive relationship between the companies concerned were clarified, that would have a

12 — In a series of judgments, the Court held that there is no requirement for an examination of national legislation in the light of Article 56 EC in addition to that carried out in the light of the freedom of establishment, if the restriction on the free movement of capital constitutes an unavoidable consequence of any restriction on freedom of establishment (See *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 34 and the case-law cited). Recently, the court applied that solution to the case where a national rule applies regardless of the extent of a holding, but the specific proceedings at issue concerned only holdings permitting an influence on the management of the company concerned (Case C-284/06 *Burda* [2008] ECR I-4571, paragraphs 71 to 74, and Case C-303/07 *Aberdeen Property Fininvest Alpha* [2009] ECR I-5145, paragraph 33). It is questionable whether the Court's observations imply that the free movement of capital always takes a back seat whenever the facts at issue in the main proceedings concern holding relationships triggering the freedom of establishment (on that point see also the Opinion of Advocate General Bot in Case C-182/08 *Glaxo Wellcome*, pending before the Court, point 86 et seq.).

bearing on the outcome of the case only if it entailed third-country elements, in which case the wider scope of the free movement of capital would become relevant. In purely intra-Community situations, however, the relationship between the freedom of establishment and the free movement of capital need not ultimately be resolved, as the conditions governing both those fundamental freedoms are, for the most part, identical.

38. There is no third-country dimension to the present case. Since an assessment in the light of the provisions governing the free movement of capital would not produce a different outcome from that reached on the basis of the freedom of establishment, on grounds of procedural economy, I intend to examine the present case only in the light of the second of those fundamental freedoms.

B — *Restriction of the freedom of establishment*

39. Freedom of establishment entails, for companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Community, the right to exercise their activity in other Member States through a subsidiary, a branch or an agency. [13]

40. Even though, according to their wording, the Treaty provisions concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation or from making such a step less attractive. [14]

41. Under subparagraph 1 of the second paragraph of Article 26 of the CIR 92, an unusual or gratuitous advantage is added back to the profits of the undertaking which granted the advantage. However, it is not added back if the advantage is taken into account in determining the taxable income of the recipient. The adding-back mechanism is not applied, however, only where the advantage is granted to a domestic company. If, on the other hand, the beneficiary company is established in another Member State and has a relationship of interdependence with the grantor company, under subparagraph 1 of the second paragraph of Article 26 of the CIR 92, the adding-back mechanism must be applied.

13 — Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 35, Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 30, and *Aberdeen Property Fininvest Alpha*, cited in footnote 12, paragraph 37.

14 — See Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 21; *Marks & Spencer*, cited in footnote 13, paragraph 31; *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited in footnote 8, paragraph 42; and Case C-418/07 *Papillon* [2008] ECR I-8947, paragraph 16.

42. Therefore, that provision lays down different rules depending on whether the company to which a resident company — with which the former has a relationship of interdependence — grants an unusual or gratuitous advantage is also a resident company or is established in another Member State.

43. However, the Belgian and German Governments argue that, when account is taken of the wider context, the legislation in question does not result in less favourable treatment in cross-border situations. They concede that adding-back of an unusual or gratuitous advantage does not operate in domestic situations, provided that the advantage is taken into account in determining the taxable income of the recipient. However, they point out that, under Articles 79 and 207 of the CIR 92, the recipient of the advantage cannot set off such income against its own losses. Thus, even in domestic situations such profits are, in the same period, subject to tax, but liability for such tax lies with the company receiving the advantage, not the company granting it.

44. However, by that argument the Belgian and German Governments have not completely rebutted the contention that the grant of an unusual or gratuitous advantage to a non-resident company is treated less favourably under the legislation than is the case with corresponding transactions between resident companies.

45. In that context, it must be observed that the Governments in question base their observations on a global view of the group of companies and presume that it is irrelevant to which company within a group particular income is attributed, so long as the transfer of the income cannot result in a more advantageous utilisation of losses within the group. However, if the companies concerned are not directly or indirectly 100%-related to each other, that approach is not necessarily justified. From the perspective of company X and its shareholders, it may indeed make a difference whether an unusual advantage granted by X to another company is added-back to its profits or added to the profits of the beneficiary company. If the latter has, in addition to X, other shareholders, other 'shoulders' also share in the tax burden.

46. However, even if it is assumed, in the present case, that it is appropriate to view the group of companies as a whole for the purposes of evaluating the tax provisions, in certain cross-border situations disadvantages arise all the same. As SGI points out and the Belgian Government itself concedes, an adjustment of the profits in the State in which the company which granted an unusual advantage is established can result in double taxation of the same income.

47. For example, payments made by SGI to Cobelpin in respect of its activities as company director were attributed to the profits of SGI (or not deducted from its income). At the same time, those same payments formed part of the tax base of

Cobelpin and were subject to tax in Luxembourg. [15] There is also the risk of a sum being taken into consideration for tax purposes more than once in relation to the notional interest on the loan to Recydem. The interest was added to the profits of SGI. However, as Recydem did not, in fact, pay any interest, the French tax authorities would be reluctant recognise such interest as operating expenses.

48. Admittedly, the Member States are correct to point out that double taxation can be eliminated through the application of the Arbitration Convention. On the basis of the Convention, Cobelpin or Recydem could request a reassessment of their income to take account of the Belgian tax treatment of the advantages granted by SGI. However, the procedure whereby the tax authorities concerned endeavour to resolve the matter by mutual agreement — should that be required — is initiated only at the taxpayer's request and thus imposes on it an additional administrative burden. Moreover, the taxpayer must bear the financial burden of the double taxation for the duration of the procedure. Thus, a procedure aimed at resolution by mutual agreement and, if necessary, a subsequent arbitration procedure may extend over several years, when full use is made of the periods laid down in the Convention for each procedural step.

49. By contrast, in the case of similar domestic transactions, the risk of double taxation is greatly reduced because the advantage is not added back when taken into consideration for tax purposes in the hands of the recipient. [16]

50. The potential double taxation of the same income in the present case is not simply the consequence of the exercise in parallel by two Member States of their fiscal sovereignty, a situation which, according to the case-law of the Court, does not run counter to the fundamental freedoms as Community law currently stands. [17] Instead, it results from different tax treatment of comparable transactions by one and the same Member State.

51. That Member State could, in principle, exclude the risk of double taxation if, in the case of advantages granted by a resident company to a non-resident company, it refrained from adjusting the former's profits when the beneficiary company is taxed on the advantage. Naturally, in that case, it would have to accept a relocation of the tax base to

15 — Admittedly, according to the referring court, Cobelpin could set off that income against its own losses. That does not alter the fact, however, that the income was subject to tax in Luxembourg and, in any event, would reduce the losses carried forward to the next tax year.

16 — As a result of the recast version of Article 26 of the CIR 92 (see footnote 5), which allows for the parallel application of Article 49 of the CIR 92, it is now also possible in domestic cases for the same income to be taxed more than once, an outcome which, according to the Belgian Constitutional Court, is nonetheless acceptable, (see judgment of 6 November 2008, cited in footnote 4). However, *ratione temporis*, the recast version does not apply to the present dispute.

17 — See, to that effect, see Case C-513/04 *Kerckhaert and Morres* [2006] ECR I-10967, paragraph 20; Case C-298/05 *Columbus Container Services* [2007] ECR I-10451, paragraphs 43 and 51; Case C-67/08 *Block* [2009] ECR I-883, paragraphs 28 and 31; and Case C-128/08 *Damseaux* [2009] ECR I-6823, paragraph 35.

the State in which the beneficiary company is established. As a result of an examination of the potential justification, it will become clear whether, in fact, that is required under Community law.

52. As an interim conclusion, it must be stated that, as a result of the different treatment it affords to domestic and cross-border transactions, national legislation such as Article 26 of the CIR 92 is liable to hinder or make less attractive the formation of establishments in another Member State. Consequently, the legislation restricts the exercise of the right to freedom of establishment guaranteed in Article 43 EC.

C — *Whether the restriction is justified*

53. A restriction on the freedom of establishment is permissible only if it is justified by overriding reasons in the public interest. It is further necessary, in such a case, that it should be appropriate to ensuring the attainment of the objective thus pursued and must not go beyond what is necessary to attain it. [18]

18 — *Marks & Spencer*, cited in footnote 13, paragraph 35; *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited in footnote 8, paragraph 47; *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 64; and *Aberdeen Property Fininvest Alpha*, cited in footnote 12, paragraph 57.

54. The governments submitting observations and the Commission share the view that a provision such as Article 26 of the CIR 92 aims to ensure a balanced allocation of the power to tax between Member States. At the same time, those parties refer to the need to combat tax avoidance through the prevention of abusive practices as justification.

55. In that regard, the German Government places emphasis on the first of those grounds of justification, submitting that this must be considered separately from justification based on the need to combat abusive practices. In any event, so it argues, the scope of any justification based on the safeguarding of a balanced allocation of the power to tax must not be limited by too narrow a definition of proportionality, such as that advocated by the Court in relation to the combat of abuse.

1. The relationship between the grounds of justification relating to the need to safeguard a balanced allocation of the power to tax and the need to combat abusive practices

56. As is known, in *Marks & Spencer*, the Court recognised the safeguarding of the allocation of the power to tax between

Member States as an overriding reason in the public interest which may justify a restriction of the fundamental freedoms. In that regard, it originally cited as related elements the avoidance of the danger that losses would be used twice and combating tax avoidance. [19] Subsequently, the Court recognised that the safeguarding of a balanced allocation of the power to tax could constitute a ground of justification even in situations in which those additional elements were not both present. [20]

57. In recognising that justification, the Court has taken account of the fact that, in substance, the power to impose direct taxation falls within the competence of the Member States. [21] In the absence of any harmonising measures at Community level, Member States retain, in addition, the power to define the criteria for allocating their powers of taxation as between themselves by concluding conventions with a view to avoiding double taxation or by unilateral measures. [22] In that context, as the Court has also held, it is not unreasonable for the Member States to draw guidance from international practice and the model conventions drawn up by the OECD. [23]

58. In other cases, the Court laid particular emphasis on the justification of preventing tax avoidance. From that perspective, national measures restricting freedom of establishment may be justified where they specifically target wholly artificial arrangements designed to circumvent the legislation of the Member State concerned. [24]

59. Such abusive arrangements therefore constitute simply a particular form of interference in the allocation of the power to tax between Member States. If artificial arrangements are adopted in order to remove income from the scope of taxation in one Member State and subject it to taxation in another State, that is quite simply interference in the balanced allocation of the power to tax. [25] Accordingly, combating such practices does not, as a general rule, constitute an end in itself but pursues the broader objective of ensuring the right of a Member State to

19 — This footnote does not apply to the English version.

20 — *Oy AA*, cited in footnote 9, paragraph 60, and Case C-414/06 *Lidl Belgium* [2008] ECR I-3601, paragraph 40.

21 — See *Marks & Spencer*, cited in footnote 13, paragraph 29; *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited in footnote 8, paragraph 40; *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 25; and *Aberdeen Property Fininvest Alpha*, cited in footnote 12, paragraph 24.

22 — See Case C-336/96 *Gilly* [1998] ECR I-2793, paragraphs 24 and 30; Case C-513/03 *Van Hilten-Van der Heijden* [2006] ECR I-1957, paragraph 47; *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 49; and *Oy AA*, cited in footnote 9, paragraph 52.

23 — *Gilly*, cited in footnote 22, paragraph 31; *van Hilten-van der Heijden*, cited in footnote 22, paragraph 48; and *Lidl Belgium*, cited in footnote 20, paragraph 22.

24 — See, in particular, *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited in footnote 8, paragraph 51, and *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 72.

25 — See *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited in footnote 8, paragraph 56.

exercise its tax jurisdiction in relation to activities carried out on its territory.

60. That does not imply, however, that the justification of a balanced allocation of the power to tax may be invoked only when the conditions for invoking the justification of combating abusive practices also are satisfied. Depending on the form and the objective of the national legislation under consideration, the safeguarding of a balanced allocation of the power to tax may be decisive either in itself or in conjunction with other grounds of justification.

61. Recourse to the criterion of artificial arrangements is necessary whenever cross-border transactions ostensibly appear to be normal economic operations. Namely, in principle, there is a presumption that a transaction is effected in the legitimate exercise of the freedom of establishment. [26] Only when such an appearance is contradicted by proof of the fact that no genuine economic reason for the specific transaction in fact exists, is there interference with the balanced allocation of the power to tax between the Member States.

26 — To that effect, see *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 73 with further references, and *Lammers & Van Cleeff*, cited in footnote 7, paragraph 27.

62. The rule laid down in Article 26 of the CIR 92 requires an assessment to be made of specific transactions between companies in a relationship of interdependence. It must be determined, in the light of the arm's length principle, whether the terms agreed are, from an economic point of view, normal or unjustified. It is appropriate, therefore, in assessing justification, to begin with an examination of whether the legislation is intended to prevent artificial arrangements adopted for tax avoidance purposes. It must then be considered whether the safeguarding of the allocation of the power to tax is in fact the underlying motive.

63. As the need to combat abusive practices in the form of artificial arrangements aimed at tax avoidance constitutes — as I have indicated — a sub-category of the justification of safeguarding a balanced allocation of the power to tax, different standards may not be applied in determining the proportionality of each ground of justification. National restrictions which cover not only abusive arrangements but also regular transactions are disproportionate because they go beyond what is necessary to attain the objective pursued. If companies established in different Member States engage in transactions under normal economic conditions, the allocation of the power to tax is unaffected. Where, however, national legislation hinders the conclusion of such transactions, it, too, is disproportionate.

2. Examination of the justification

64. First, it is necessary to determine whether Article 26 of the CIR 92 is appropriate for the purpose of attaining the objectives pursued.

65. In order to differentiate artificial arrangements undermining the allocation of the power to tax from normal business transactions, Article 26 of the CIR 92 establishes as distinguishing criteria, first, a relationship of interdependence between the companies concerned and, second, the unusual or gratuitous nature of the advantage conferred. If those requirements are satisfied, the advantage is added back to the tax base of the company which granted the advantage.

66. In the main proceedings, as a result of the application of that provision, interest at a rate of 5% — which, in the assessment of the tax authorities, SGI could have earned on its loan to Recydem — was added to SGI's income. The payments to Cobelpin for its services as director were also added back to the tax base of SGI, as these were not matched by any genuine consideration from Cobelpin.

67. The national provision is based on Article 9 of the OECD Model Convention and Article 4 of the Arbitration Convention, which provide for corresponding adjustments to profits when transactions between associated companies fail to satisfy the at-arms-length test.

68. In *Test Claimants in the Thin Cap Group Litigation*, the Court recognised, in principle, that the arm's-length principle constitutes an appropriate test by which to distinguish artificial arrangements from genuine economic transactions. The Court stated as follows with regard to the rules on thin capitalisation at issue in that case:

'The fact that a resident company has been granted a loan by a non-resident company on terms which do not correspond to those which would have been agreed upon at arm's length constitutes, for the Member State in which the borrowing company is resident, an objective element which can be independently verified in order to determine whether the transaction in question represents, in whole or in part, a purely artificial arrangement, the essential purpose of which is to circumvent the tax legislation of that Member State. In that regard, the question is whether, had there been an arm's-length relationship between the companies concerned, the loan would not have been granted or would have been granted for a different amount or at a different rate of interest.' [27]

27 — *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 81; see also *Lammers & Van Cleeff*, cited in footnote 7, paragraph 30.

69. Admittedly, Article 26 of the CIR 92 deviates, in detail, from Article 9 of the OECD Model Convention, which provides Member States with useful guidance on the allocation of the power to tax. Thus, under Article 26 of the CIR 92, participation in management, control or capital is not regarded as substantive proof of a relationship of interdependence between companies. Further, it does not expressly require a comparison to be made with the conditions under which a corresponding transaction would have been effected between independent companies. However, the interpretation applied by the domestic courts to the concept of an unusual advantage demonstrates that that was indeed the intention. [28]

70. The concept of a direct or indirect relationship of interdependence limits the category of companies having a potential interest in agreeing atypical terms and conditions of business for the purposes of tax avoidance. Admittedly, that concept is extremely broad. While the Court has held that, under Community law, a taxpayer must be aware of the obligations imposed on him, in particular in the case of rules entailing financial consequences, [29] the national provision does not infringe the principle of legal certainty. Legislation aimed at counteracting abusive practices must inevitably have recourse to imprecise legal concepts in order to cover the greatest number of conceivable arrangements created for the purposes of tax avoidance. Moreover, a relationship of interdependence is not the only determining factor. Of greater and indeed primary significance is whether, between companies in a relationship of interdependence, unusual or gratuitous advantages were granted.

71. Notwithstanding those differences in relation to Article 9 of the OECD Model Convention and Article 4 of the Arbitration Convention, Article 26 of the CIR 92 is appropriate for the purpose of attaining the objective of counteracting artificial arrangements adopted for the purposes of tax avoidance.

72. By excluding the possibility for undertakings in a relationship of interdependence with each other to grant unusual or gratuitous advantages and thus transfer profits from the tax base of a resident company to that of a non-resident company, Article 26 of the CIR 92 also safeguards the balanced allocation of the power to tax.

73. Such advantages are, in fact, disguised profit transfers between undertakings in a relationship of interdependence with each other. In *Oy AA*, the Court held that payments between associated companies undermine the allocation of the power to tax. If such transfers were to be recognised for tax purposes, companies within a group could choose

28 — See above point 9 of this Opinion.

29 — See Case C-255/02 *Halifax and Others* [2006] ECR I-1609, paragraph 72.

freely the Member State in which profits are to be taxed, regardless of where they were generated. [30]

74. However, it remains to be determined whether the legislation in question goes beyond what is necessary to attain those objectives.

75. On that point, first, it follows from *Test Claimants in the Thin Cap Group Litigation* that legislation designed to prevent artificial arrangements, in reliance on the arm's length principle, may refuse to recognise such arrangements for tax purposes only if, and in so far as, those arrangements differ from what independent companies would have agreed on an arm's-length basis. [31] Therefore, the fact that the price for the provision of services between associated companies is abnormally low or excessively high may not, for example, result in a refusal to recognise the entire transaction as legitimate for tax purposes. Instead, such prices must be raised or, where appropriate, reduced to the normal level for tax purposes. [32]

76. Admittedly, the wording of Article 26 of the CIR 92 does not indicate unequivocally whether, in all cases, the adjustment of profits entails applying normal conditions to unusual advantages. However, the provision was clearly interpreted and applied by the tax authorities and courts in such a manner. The amount of interest added to SGI's income was determined by reference to the usual market interest rates. Subject to any definitive finding of the referring court, it must be presumed, therefore, that the provision, as applied in practice, complies with the principle of proportionality.

77. Second, legislation intended to combat abuse must give the taxpayer, on each occasion on which an artificial arrangement is suspected, the opportunity to provide evidence of any commercial justification that there may have been for that arrangement. [33]

78. Article 26 of the CIR 92 requires an unusual or gratuitous advantage to have been conferred. That provision does not exclude the possibility for the taxpayer to contest any such assessment made by the tax authorities. For those purposes, it must prove that the

30 — To that effect, see *Oy AA*, cited in footnote 9, paragraphs 55 and 56 and, in relation to the transfer of losses, *Marks & Spencer*, cited in footnote 13, paragraphs 45 and 46, and *Lidl Belgium* cited in footnote 20, paragraph 32.

31 — *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 80, and *Lammers & Van Cleeff*, cited in footnote 7, paragraph 29.

32 — To that effect, see *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 83.

33 — To that effect, see *Test Claimants in the Thin Cap Group Litigation*, cited in footnote 8, paragraph 82 and Case C-201/05 *Test Claimants in the CFC and Dividend Group Litigation* [2008] ECR I-2875, paragraph 84.

contested transaction is in fact economically justified, and that independent companies acting at arm's length would have concluded the transaction on the same terms.

79. In the present case, it is evident from the order for reference that the grant by SGI to Recydem of an interest-free loan was not justified in economic terms, as SGI itself was highly indebted whereas the financial position of Recydem was secure. Nor, in the view of the referring court, could SGI establish that the payments to Cobelpin constituted appropriate remuneration for its services as director.

80. Finally, it must be observed that the negative effects of any adjustment of profits in accordance with Article 26 of the CIR 92 are largely neutralised by the fact that the beneficiary undertaking may require, on the basis of the Arbitration Convention, account to be taken of such an adjustment in connection with its own tax assessment. The additional burdens associated with such a procedure [34] must be accepted, since no less onerous measure is available to safeguard the balanced allocation of the power to tax. [35]

81. It follows that a rule such as that laid down by Article 26 of the CIR 92 does not go beyond what is necessary to maintain a balanced allocation of the power to tax between the Member States and to prevent tax avoidance.

82. Thus, a rule such as that laid down in Article 26 of the CIR 92 results in a restriction on the freedom of establishment guaranteed by Article 43 EC, in conjunction with Article 48 EC. However, such a rule is justified on grounds of the need to safeguard the balanced allocation of the power to tax between the Member States and to prevent tax avoidance.

34 — See point 48 above.

35 — In adopting the Arbitration Convention, the Member States even have gone beyond what Community law requires. According to the Court's case-law, a Member State is not required to take account, for the purposes of applying its tax law, of the possible negative results arising from particularities of legislation of another Member State applicable to a permanent establishment situated in the territory of the said State which belongs to a company with a registered office in the first State (see Case C-157/07 *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* [2008] ECR I-8061, paragraph 49 and the case-law cited).

V — Conclusion

83. In the light of the foregoing considerations, I propose that the Court should answer the questions referred as follows:

Article 43 EC, in conjunction with Article 48 EC, does not preclude legislation of a Member State, such as Article 26 of the Belgian Code des impôts sur les revenus 1992, which gives rise to the taxation of a resident company in respect of an unusual or gratuitous advantage which it granted to a company with which, directly or indirectly, it has a relationship of interdependence, that is established in another Member State, whereas, in identical circumstances, the resident company cannot be taxed on an unusual or gratuitous advantage if the advantage is granted to another resident company with which it has a relationship of interdependence.