JUDGMENT OF THE COURT

26 October 1999 *

In Case C-294/97,

REFERENCE to the Court under Article 177 of the EC Treaty (now Article 234 EC) by the Finanzgericht Münster, Germany, for a preliminary ruling in the proceedings pending before that court between

Eurowings Luftverkehrs AG

and

Finanzamt Dortmund-Unna

on the interpretation of Article 59 of the EC Treaty (now, after amendment, Article 49 EC),

THE COURT,

composed of: G.C. Rodríguez Iglesias, President, J.C. Moitinho de Almeida (Rapporteur), D.A.O. Edward, L. Sevón (Presidents of Chambers),

* Language of the case: German.

P.J.G. Kapteyn, C. Gulmann, J.-P. Puissochet, G. Hirsch, P. Jann, H. Ragnemalm and M. Wathelet, Judges,

Advocate General: J. Mischo,

Registrar: H.A. Rühl, Principal Administrator,

after considering the written observations submitted on behalf of:

— Eurowings Luftverkehrs AG, by W. Tillmann, tax adviser, Dortmund, and W. Kaefer, tax adviser, Aix-la-Chapelle, and G. Saß, Manager of the European Department,

— Finanzamt Dortmund-Unna, by E. Scheidemantel, Lietender Regierungsdirektor,

— the German Government, by E. Röder, Ministerialrat at the Federal Ministry of the Economy, and C.-D. Quassowski, Regierungsdirektor at the same ministry, acting as Agents,

— the Commission of the European Communities, by J. Sack, Legal Adviser, and H. Michard, of its Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Eurowings Luftverkehrs AG, of the German Government and of the Commission at the hearing on 2 December 1998,

after hearing the Opinion of the Advocate General at the sitting on 26 January 1999,

gives the following

Judgment

1 By an order of 28 July 1997, received at the Court on 11 August 1997, the Finanzgericht (Finance Court) Münster referred to the Court for a preliminary ruling under Article 177 of the EC Treaty (now Article 234 EC) a question on the interpretation of Article 59 of the EC Treaty (now, after amendment, Article 49 EC).

2 The question was raised in a dispute between Eurowings Luftverkehrs AG ('Eurowings') and Finanzamt (Tax Office) Dortmund-Unna ('the Tax Office') as to whether Eurowings was obliged to add various amounts back to the taxable amount for trade tax under the Gewerbesteuergesetz (Trade Tax Law).

The German legislation

3 Paragraph 2 of the Trade Tax Law of 21 March 1991 (BGBl. I, p. 814) provides that any business currently operating in Germany is subject to trade tax on capital and earnings.

4 Business tax is a non-personal tax payable by any business establishment regardless of the resources and personal situation of the taxpayer who owns it.

5 Paragraph 6 of the Law provides that the tax applies to trade earnings and capital. Since 1 January 1998 it has been restricted to trade earnings.

6 Trade earnings are the amount determined in accordance with the provisions of the Income Tax Law or the Corporation Tax Law, plus the add-backs required by Paragraph 8 of the Trade Tax Law and minus the deductions provided for in Paragraph 9 thereof. The purpose of the add-backs and deductions is to enable the objective earnings of the business to be determined regardless of whether they arise on the investment of own or outside capital.

7 Paragraph 8 of the Trade Tax Law, entitled 'Add-backs', thus provides in point 7 that there must be added to the earnings of the business:

'half of the rental payments made for the use of fixed business assets, other than real estate, owned by another person. This does not apply where the payments are to be taken into account for the purposes of trade tax on the lessor's earnings, unless the lease is of an undertaking or part of an undertaking and the rental

payments exceed DEM 250 000. The amount to be taken into account is that which the lessee has to pay to a lessor for use of business assets which he does not own in the business establishment within a municipality'.

8 It is thus presumed for the purposes of the Trade Tax Law that the net income from the rental represents half of the rental paid.

9 Trade capital corresponds to the taxable value of the business capital determined in accordance with the Bewertungsgesetz (Valuation Law), plus the add-backs required by Paragraph 12(2) of the Trade Tax Law and minus the deductions provided for in Paragraph 12(3) of the Law. The purpose of the add-backs and deductions is to enable third-party assets objectively used in the business to be determined.

10 Paragraph 12(2)2 of the Trade Tax Law, entitled 'Trade capital', provides that there shall be added to the taxable value of the business:

'The (current) value of business assets, other than real property, used for the purposes of the business but owned by a member of the business or by a third party, to the extent that they are not included in the taxable value of the business. This does not apply where the assets form part of the lessor's trade capital, unless a business or part of a business is leased and the (current) value of the leased assets of the business or part of a business included in the lessor's trade capital exceeds DEM 2.5 million. The amount to be taken into account is the total value of the business assets made available by a lessor to the lessee for use in the business establishment within a municipality.'

11 As is provided in the second sentence of Paragraph 8(7) with regard to rental payments, the second sentence of Paragraph 12(2)2 of the Trade Tax Law provides in the case of business assets belonging to a third party that they are not to be added back where trade tax is already payable on them by the lessor.

12 According to the observations submitted to the Court by Eurowings, trade tax is calculated in two stages: first of all, it is applied to capital and earnings at a basic rate fixed uniformly for the whole of Germany at 0.2% for capital and 5% for earnings of capital companies; a rate determined separately by each municipality is then applied to the amount thus obtained. In 1993 the latter rate varied from 0%, notably in Norderfriedrichskoog in Schleswig-Holstein, to 515% in Frankfurt-am-Main. In Dortmund the rate applicable in 1993 was 450%.

Facts

13 Eurowings operates scheduled and charter flights in Germany and Europe. In 1993 it leased an aircraft from Air Tara Ltd, an Irish limited company established at Shannon, for DEM 467 914. The current value of the aircraft was DEM 1 320 000. By decision of 21 May 1996 the Tax Office determined the trade tax payable for 1993, including by way of add-back to the earnings under Paragraph 8(7) of the Trade Tax Law half of the lease instalments actually paid, amounting to DEM 233 957. In accordance with Paragraph 12(2) of the Law it also included in the business capital the current value of the leased aircraft, being DEM 1 320 000.

14 On 13 June 1996 Eurowings lodged a complaint against that decision, which was rejected by decision of 8 July 1996.

15 It then brought an action before the Finanzgericht Münster on 11 July 1996, claiming that Paragraphs 8(7) and 12(2) of the Trade Tax Law were incompatible with Article 59 et seq. of the Treaty.

16 The Finanzgericht observes that Eurowings is entitled in Community law to plead discrimination prohibited by Article 59 of the Treaty even if the victim of the discrimination is not Eurowings but the undertaking governed by Irish law which is the lessor.

17 It also observes that Irish limited companies are equivalent to German capital companies within the meaning of Paragraph 1 of the Corporation Tax Law and that if such undertakings were to lease out aircraft in Germany that activity would be regarded entirely as a business for the purposes of Paragraph 2 of the Trade Tax Law.

18 The Finanzgericht points out that the add-back provisions relating to trade tax reflect the intention of the legislature to ensure that the assets of businesses established in Germany are taxed only once, regardless of whether the assets are financed by own or outside investment and how the business capital is owned for the purposes of civil law. Such a system makes it necessary to provide for an exception where trade tax on the rental income or assets concerned is already payable by the lessor.

19 The national court notes, however, that lessees receive more favourable treatment for tax purposes if they lease goods from a lessor established in Germany than if they lease from a lessor established in another Member State, which might amount to covert discrimination prohibited by Article 59 of the Treaty.

20 It doubts that coherency of taxation is an aim capable of justifying the provisions of the Trade Tax Law in question. The Court has held (in Case C-80/94 *Wielockx* v *Inspecteur der Directe Belastingen* [1995] ECR I-2493 and Case C-484/93 *Svensson and Gustavsson* v *Ministre du Logement et de l'Urbanisme* [1995] ECR I-3955) that the aim of ensuring coherency of taxation is not sufficient to justify a difference in treatment between residents and non-residents unless the tax disadvantage resulting for a national of a Member State is compensated for by a corresponding tax advantage for the same person, with the result that he suffers no discrimination. The existence of a merely indirect link between the tax advantage accorded to one taxable person and the unfavourable tax treatment of another cannot justify discrimination as between residents and non-residents. The Finanzgericht stated in that regard that in an order dated 30 December 1996 (BStBl. II 1997, p. 466) the Bundesfinanzhof (Federal Finance Court) considered it doubtful that the provisions on add-back to the taxable amount contained in the second sentence of Paragraph 8(7) and the second sentence of Paragraph 12(2)2 of the Trade Tax Law were compatible with the prohibition on discrimination set out in Article 59 et seq. of the Treaty, even though the same court had held that they were in a previous decision (judgment of 15 June 1983, BStBl. II 1984, p. 17).

21 Lastly, the Finanzgericht asks whether it is necessary to take into account the fact that the lessor, an undertaking governed by Irish law, pays no tax comparable to the trade tax and enjoys 'Shannon privileges' in the form of a 10% corporation tax. Such tax advantages might be sufficient, in the main action, to outweigh the theoretical restriction of the freedom to provide services and mean that if the lessor enjoys the same exemptions as regards add-back as lessors established in Germany the latter would suffer discrimination. It doubts that such an argument can succeed, as the Court has also held that unfavourable tax treatment cannot be compensated for by other tax advantages in order to justify discrimination (Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 21, and Case C-107/94 *Asscher* v *Staatssecretaris van Financië* [1996] ECR I-3089).

22 In the circumstances the Finanzgericht decided to stay proceedings and refer the following question to the Court for a preliminary ruling:

'Are the add-back provisions in the second sentence of Paragraph 8(7) and the second sentence of Paragraph 12(2)2 of the Gewerbesteuergesetz (Trade Tax Law) compatible with the principle of freedom to provide services under Article 59 of the Treaty on European Union of 7 February 1992?'

The question

23 The national court asks in substance whether Article 59 of the Treaty precludes national legislation on trade tax such as that at issue in the main action.

24 The German Government maintains that Paragraphs 8(7) and 12(2) of the Trade Tax Law do not entail any direct or indirect discrimination with regard to providers of services established in other Member States.

25 It points out, first of all, that the obligation to add back provided for in those provisions applies where the lessor is not liable to trade tax, whether he is established in Germany or in another Member State. The lessee, likewise, must make such add-backs if he leases from a lessor established in Germany who is not liable to such a tax.

26 Thus for example a lessee who leases a chemist's shop from a chemist established in Germany who has ceased business and is therefore no longer liable to trade tax must add back to the earnings of the business half of the amount paid for the lease of the premises.

27 The same applies where goods are leased from a lessor established in Germany but free of liability to trade tax or, as in the case of the federal, regional or local authorities, not subject to that tax as a public law body. Where a port undertaking rents a crane from a port town, for instance, it must add half the amount of the rental paid for the crane to its earnings.

28 Next, the German Government maintains, as does the Tax Office, that in the absence of harmonisation of direct taxation the situation of a lessor established in another Member State who is not liable to trade tax cannot be compared to that of a lessor established in Germany who is so liable, so that it is permissible for different rules to apply to those situations.

29 The reason is that a lessor established in another Member State might be able to charge the lessee a lower rental because he is not liable to trade tax. A lessor established in Germany who is liable to trade tax, by contrast, would pass it on to the lessee by incorporating it in the rental.

30 The add-backs provided for in Paragraphs 8(7) and 12(2)2 of the Trade Tax Law serve to balance the lower rent paid by the lessee to the lessor established in another Member State. The latter is not placed at any competitive disadvantage

by those add-backs, however, as in both cases the burden of the tax is the same and falls to be paid ultimately by the lessee established in Germany.

31 Lastly, the German Government observes that the purpose of the add-backs provided for in Paragraph 8(7) and Paragraph 12(2) of the Trade Tax Law is to ensure that trade tax is charged on both the rental and the value of the assets leased only once, regardless of whether the lessor is established in Germany or in another Member State. Adding back the amount of the rental and the value of the assets rented to the taxable amount for the lessee where the lessor is liable to trade tax would lead to double taxation of rental and assets.

32 The first observation to be made is that although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must be exercised consistently with Community law (see *inter alia* Case C-279/93 *Finanzamt Köln — Altstadt* v *Roland Schumacker* [1995] ECR I-225, paragraph 21).

33 Next, since leasing is a service within the meaning of Article 60 of the EC Treaty (now Article 50 EC), it should be noted that the Court has held that Article 59 of the Treaty requires not only the abolition of any discrimination on account of nationality against a person providing services but also the abolition of any restriction on the freedom to provide services imposed on the ground that the person providing service is established in a Member State other than the one in which the service is provided (Case 205/84 *Commission* v *Germany* [1986] ECR 3755, paragraph 25, and Case C-180/89 *Commission* v *Italy* [1991] ECR I-709, paragraph 15).

34 It has also consistently held that Article 59 of the Treaty confers rights not only on the provider of services but also on the recipient (see *inter alia* Joined Cases 286/82 and 26/83 *Luisi and Carbone* v *Ministero del Tesoro* [1984] ECR 377 and *Svensson and Gustavsson*, cited above). As the recipient of the leasing services, therefore, Eurowings may rely on the individual rights conferred on it by that provision.

35 In that regard, it is to be noted that in the main action the obligation to make the add-backs provided for in Paragraph 8(7) and Paragraph 12(2) of the Trade Tax Law is always applicable for German undertakings leasing goods from lessors established in another Member State, since the latter are never liable to pay the trade tax, whereas that obligation does not apply, in most cases, for German undertakings leasing goods from lessors established in Germany, the latter being generally liable to the tax, save in the rare instances mentioned in paragraphs 25 to 27 of this judgment.

36 The legislation at issue in the main case therefore establishes tax rules which differ, in the large majority of cases, according to whether the provider of the services is established in Germany or in another Member State.

37 In addition, as the national court noted, the legislation contains tax rules which are less favourable to German undertakings leasing goods from lessors established in other Member States, who may thus be dissuaded from having recourse to such lessors.

38 As Eurowings has observed, without being contradicted on that point by the German Government, the holder of a German lease is generally exempt solely as a result of the fact that the lessor himself is liable to trade tax, regardless of the possibilities open to him to avoid actually paying the tax. The file in the main case indicates that there are a number of ways in which the lessor may reduce his tax liability, including using the accounting value rather than the market value of the assets, adding back half rather than the whole of long-term debts, lease-purchase

arrangements for assets in order to reduce business capital and the inclusion of only the real income from goods leased in Germany and not half of the rental from them. In addition, the leasing funds offered by German banks ensure that capital gains tax need never be paid and tax on trade capital need be paid in respect of only part of the duration of a contract. Finally, since those who lease out aircraft are not dependent on a town with an airport, they may establish themselves in a municipality which has fixed the rate for calculation of trade tax at a very low percentage, or even at zero.

39 In those circumstances the burden of the trade tax for German undertakings leasing goods from lessors established in Germany does not necessarily correspond, contrary to what the German Government maintains, to the burden of that tax for German undertakings leasing goods from lessors established in another Member State.

40 However, any legislation of a Member State which, like that at issue in the main action, reserves a fiscal advantage to the majority of undertakings which lease goods from lessors established in that State whilst depriving those leasing from lessors established in another Member State of such an advantage gives rise to a difference of treatment based on the place of establishment of the provider of services, which is prohibited by Article 59 of the Treaty.

41 Such a difference of treatment cannot be justified on grounds linked to the need for coherency of taxation.

42 As the Bundesfinanzhof observed in an order of 30 December 1996 referred to by the national court which made the reference in this case, a merely indirect link between a fiscal advantage accorded to a taxable person, such as the absence in the case of German undertakings leasing from lessors established in Germany of

the obligation to make the add-backs in question, and unfavourable tax treatment of another taxable person, such as the liability of such lessors to pay trade tax, cannot be used to justify the fact that German undertakings are treated differently according to whether they lease from lessors established in Germany or from lessors established in other Member States.

43 Contrary to what was argued by the Finanzamt, that difference of treatment can also not be justified by the fact that the lessor established in another Member State is there subject to lower taxation.

44 Any tax advantage resulting for providers of services from the low taxation to which they are subject in the Member State in which they are established cannot be used by another Member State to justify less favourable treatment in tax matters given to recipients of services established in the latter State (see, as regards Article 52 of the EC Treaty (now, after amendment, Article 43 EC), *Commission* v *France*, paragraph 21, and *Asscher*, paragraph 53, both cited above).

45 As the Commission rightly observed, such compensatory tax arrangements prejudice the very foundations of the single market.

46 The reply to be given to the national court is therefore that Article 59 of the Treaty precludes national legislation on trade tax such as that at issue in the main action.

Costs

47 The costs incurred by the German Government and by the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main action, a step in the proceedings pending before the national court, a decision on costs is a matter for that court.

On those grounds,

THE COURT,

in answer to the question referred to it by the Finanzgericht Münster by order of 28 July 1997, hereby rules:

Article 59 of the EC Treaty (now, after amendment, Article 49 EC) precludes national legislation on trade tax such as that at issue in the main action.

Rodríguez Iglesias Moitinho de Almeida

Edward Sevón Kapteyn

Gulmann Puissochet Hirsch

Jann Ragnemalm Wathelet

Delivered in open court in Luxembourg on 26 October 1999.

R. Grass

Registrar

G.C. Rodríguez Iglesias

President