OPINION OF ADVOCATE GENERAL LÉGER

delivered on 13 March 2003 [1]

1. The present reference for a preliminary ruling from the Finanzgericht Berlin (Germany) concerns the situation with regard to income tax of a non-resident Netherlands national who has provided services in Germany. This type of transborder situation is governed by the treaty of 16 June 1959 concluded between the Kingdom of the Netherlands and the Federal Republic of Germany in order to avoid double taxation. [2]

I — National legal framework

2. The German Law on Income Tax (Einkommensteuergesetz), in the version in force in 1996 (hereinafter 'EStG 1996'), distinguishes between the taxation of residents, who are wholly taxable persons, and that of non-residents, who are partially taxable persons. EStG 1996 provides for wholly taxable persons to be taxed on their net income at a rate determined by a progressive tax scale incorporating a non-taxable basic allowance.

3. Paragraph 50a(4) of EStG 1996 deals with the taxation of the income of partially taxable persons, which is to say persons who have neither their permanent residence nor their ordinary abode in Germany and who are taxed in Germany on the income earned in that State. As provided in the said Paragraph 50a(4):

'In the case of partially taxable persons, income tax shall be deducted at source:

1. In respect of income from artistic, sporting or similar performances in national territory or from the exploitation of such performances in national territory, including income derived from other acts of performance connected with the above, irrespective of the person who receives the income...

...

1 — Original language: French.

2 — BGBl. 1960, p. 1782.

The deduction at source shall be 25% of the income received...'

4. The income referred to in Paragraph 50a(4) of EStG 1996 includes all receipts by the taxable person in money or in money's worth, with no deductions allowed for business expenses, extraordinary expenses and taxes.

5. By virtue of the deduction of tax at source, the income tax is, in principle, treated as definitively paid. No provision is made for refunds. [3] The only possible exception is where business expenses amount to more than half of receipts. [4]

6. Under Paragraph 1(3) of EStG 1996, certain persons falling within the scope of Paragraph 50a thereof may apply to be treated like persons wholly subject to income tax. In such cases, their tax treatment is aligned, subsequently, with that of a wholly taxable person. Partially taxable persons may exercise this right only if one of the following conditions is met: either at least 90% of the income must, during the calendar year, have been subject to German income tax, or the income not subject to German income tax during the calendar year must not exceed DEM 12 000.

7. Persons exercising this right are then subject to the same rules under EStG 1996 as wholly taxable persons. Under German law, the latter are assessed in respect of income from a self-employed activity on the basis of net profit (receipts less actual expenses). Furthermore, a progressive tax scale applies to their earnings, which incorporates a non-taxable basic allowance. [5]

II — Facts of the case and main proceedings

8. Arnoud Gerritse is a national of the Netherlands who exercised a self-employed activity in Germany in the course of 1996. He performed as a drummer at a radio station in Berlin on 25 April 1996. His fee was DEM 6 007.55. The radio station deducted 25%, [6] namely DEM 1 501.89, from that amount as flat-rate income tax (deduction at source procedure) and DEM 112.64 as a solidarity levy.

3 — Paragraph 50(5) of EStG 1966.

4 — Paragraph 50(5)(3), sentence 2, of EStG 1997, applicable retrospectively to remuneration received after 31 December 1995.

5 — For 1996, the non-taxable basic allowance was DEM 12 095 (Article 32a of EStG 1996).

6 — In accordance with Paragraph 50a(4) of EStG 1966.

9. In the same year Mr Gerritse earned further income amounting to about DEM 55 000 in the Netherlands, his State of permanent residence, and in Belgium.

10. By virtue of the treaty concluded between the Kingdom of the Netherlands and the Federal Republic of Germany in order to avoid double taxation, income earned by Mr Gerritse in Germany is subject to income tax in that Member State. Under German law, such tax levies are deducted at source and are calculated by applying a flat rate of 25% to the gross income.

11. In accordance with Paragraph 1(3) of EStG 1996, Mr Gerritse applied to the Finanzamt Neukölln-Nord (Germany), on 4 September 1998, to be treated as a wholly taxable person.

12. The Finanzamt rejected that application by decision of 3 December 1998.

13. Mr Gerritse has applied to the Finanzgericht Berlin to have that decision set aside. He claims that, in accordance with the judgment in *Biehl*[7] and with the principle of non-discrimination guaranteed by Community law, he is entitled to an income tax assessment, like a wholly taxable person, because a resident in a comparable situation would not have to pay any tax on revenue as he would be entitled to the basic allowance of DEM 12 095.[8]

III — The question referred

14. The Finanzgericht Berlin has decided to stay proceedings and has referred the following question to the Court for a preliminary ruling:

'Is there an infringement of Article 52 of the EC Treaty (now, after amendment, Article 43 EC) where, under Paragraph 50a(4), first sentence, point 1, and second sentence, of [EStG 1996], a Netherlands national who earns in the Federal Republic of Germany taxable net income of approximately DEM 5 000 from self-employed activity in the calendar year is subject to deduction of tax at source by the person liable to pay his fees at the rate of 25% of his (gross) revenue of approximately DEM 6 000 plus solidarity surcharge, where it is not possible, by means of an application for a refund or an application for a tax assessment, for him to recover, in whole or in part, the taxes paid?'

7 — Case C-175/88 [1990] ECR I-1779.

8 — Paragraph 32a(1)(2)(1) EStG 1996, provided for in the basic scale for income tax.

IV — Assessment

15. Like Mr Gerritse and the Commission of the European Communities, I consider that the question referred by the Finanzgericht Berlin should be interpreted as relating to Article 59 of the EC Treaty (now, after amendment, Article 49 EC) and not to Article 52 of the Treaty [9] inasmuch as a situation such as that in the main proceedings falls, by virtue of the temporary nature of the self-employed activity exercised by the plaintiff, within the scope of the Treaty provisions concerning the freedom to supply services. [10]

16. It should be remembered, first of all, that under German law different tax rates apply to the income of wholly taxable persons on the one hand, that is to say residents, and that of partially taxable persons, that is to say non-residents, on the other. Specifically, German law provides for the application of progressive tax rates, with a non-taxable basic allowance, in the case of residents and a flat rate of 25% in the case of non-residents.

17. Secondly, German law deals differently with business expenses depending on whether the income concerned is that of a resident or a non-resident. More particularly, it allows such expenses to be deducted from the taxable income of residents, whereas non-residents may not deduct them from their taxable income.

18. In the light of these considerations, the question referred should be understood as seeking to ascertain whether national legislation on income tax which, as in the present case, treats residents and non-residents differently is contrary to Article 59 of the Treaty. Under that legislation, the income of residents is taxed in accordance with a progressive scale incorporating a non-taxable basic allowance while that of non-residents is taxed at a flat rate; moreover, residents are taxed on their net income, after deduction of their business expenses, while non-residents are taxed on their gross income, with no deduction of such costs.

19. It is settled case-law 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 nevertheless be exercised consistently with Community law'. [11] It follows that the Member States, in the exercise of the powers

9 — See Case 35/85 *Tissier* [1986] ECR 1207, paragraph 9.

10 — See Case C-55/94 *Gebhard* [1995] ECR I-4165, paragraph 39.

11 — See Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 21, Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 16, Case C-107/94 *Asscher* [1996] ECR I-3089, paragraph 36, Case C-391/97 *Gschwind* [1999] ECR I-5451, paragraph 20, and Case C-55/00 *Gottardo* [2002] ECR I-413, paragraph 32.

retained by them, must not infringe the fundamental freedoms guaranteed by the Treaty, such as the freedom to supply services. [12]

20. Similarly, the Court has held that, '[i]n the perspective of a single market and in order to permit the attainment of the objectives thereof, Article 59 of the Treaty precludes the application of any national legislation which has the effect of making the provision of services between Member States more difficult than the provision of services purely within one Member State'. [13]

A — *On the flat rate of tax of 25%*

21. In the first part of the question referred, the national court asks whether national legislation on income tax which, as in the present case, taxes the income of a resident and that of a non-resident differently, the former being taxed in accordance with a progressive scale incorporating a non-taxable basic allowance and the latter being taxed at a flat rate, is contrary to Article 59 of the Treaty.

22. I consider that the application to the income earned by Mr Gerritse in Germany of a flat rate of tax of 25%, rather than the application of a progressive scale incorporating a non-taxable basic allowance, is not contrary to the Treaty provisions on the freedom to supply services.

23. The Court has consistently held [14] that the rules regarding equality of treatment forbid not only overt discrimination based on nationality but also all covert forms of discrimination which, by the application of other distinguishing criteria, lead to the same result.

24. Thus, national rules which apply irrespective of the nationality of the taxpayer concerned but which draw a distinction on the basis of residence in that non-residents are denied certain benefits which are, conversely, granted to persons residing within national territory are liable to operate mainly to the detriment of nationals of other Member States, non-residents being in the majority of cases foreigners. [15]

25. It is also settled law that discrimination can arise only through the application of

12 — See Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 31, and Case 300/90 *Commission* v *Belgium* [1992] ECR I-305, paragraph 22.

13 — See Case C-136/00 *Danner* [2002] ECR I-8147, paragraph 29. See also the judgment in Case C-381/93 *Commission* v *France* [1994] ECR I-5145, paragraph 17.

14 — See Case 152/73 *Sotgiu* [1974] ECR 153, paragraph 11, and Case C-330/91 *Commerzbank* [1993] ECR I-4017, paragraph 14.

15 — See *Schumacker*, cited above (paragraph 28).

different rules to comparable situations or the application of the same rule to different situations. [16]

26. In relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable. [17] It follows that it is possible for a Member State to lay down different rules in this area, depending on whether they apply to residents or to non-residents.

27. In this case, the bulk of Mr Gerritse's income is earned in his State of residence and he derives only a very small part of his income from his activity in Germany. Mr Gerritse's situation is not comparable with that of a German resident, exhibiting as it does objective differences with the latter situation as regards source of income, personal ability to pay tax and the account taken of personal and family circumstances. [18]

28. The objective difference in situation is such as to justify different treatment by the application of different rules in a case such as this. [19] That difference in treatment must not however call into question the freedom to supply services or place Mr Gerritse at a disadvantage.

29. It therefore has to be considered whether application of a fixed rate of tax as in the present case, rather than application of the progressive scale incorporating a non-taxable basic allowance, is such as to place Mr Gerritse's activity in Germany at a disadvantage and, by the same token, imperil implementation of the principle of the freedom to supply services.

30. To do so I will consider, firstly, whether Mr Gerritse is indeed entitled to claim the non-taxable basic allowance. I will then consider whether application of the 25% flat rate, rather than of the progressive scale, places Mr Gerritse at a real disadvantage.

31. The Finanzamt Berlin, [20] the Finnish Government [21] and the Commission [22] observe that there is no need, where Mr Gerritse is concerned, to take account of the non-taxable basic allowance provided for in German law as that legal provision

16 — Ibid. (paragraph 30).

17 — Ibid. (paragraphs, 31, 33 and 34).

18 — See the judgments, cited above, in *Wielockx* (paragraph 18), *Schumacker* (paragraph 31 et seq.), *Asscher* (paragraph 41), *Gschwind* (paragraph 22) and the judgment in Case C-87/99 *Zurstrassen* [2000] ECR I-3337, paragraph 21.

19 — See, in this connection, the judgments, cited above, in *Schumacker* (paragraphs 36 to 38) and *Asscher* (paragraph 42).

20 — See its written observations (p. 3).

21 — See its written observations (point 10).

22 — See its written observations (points 31 and 32).

has a social purpose, namely to exempt from any form of income tax the minimum amount required by the taxable person for subsistence.

32. I share that view. It is settled case-law that where the major part of a person's income is concentrated in his State of residence, it is for that State to guarantee him the minimum subsistence amount and not for other Member States in which the person concerned has also earned income. [23] In this case, it does not therefore lie with the Federal Republic of Germany to guarantee Mr Gerritse the minimum subsistence amount as he receives only a very small proportion of his income in that State.

33. As regards the amount of the flat rate of tax, set at 25% in this case, I draw attention to the judgment in *Asscher*, in which the Court ruled that non-residents cannot be expected to pay tax at a higher rate than residents, at least where the income earned by the non-resident in the State in which the economic activity concerned is pursued is taken into account in the application of the progressive scale in the State in which he resides. [24]

34. Both these conditions are met in the present case.

35. Firstly, in accordance with the treaty concluded in order to avoid double taxation, the State of permanent residence, the Netherlands, took the income earned by Mr Gerritse in Germany into account in applying progressive tax rates to his worldwide income. The Netherlands Government emphasises in its reply to the Court that it takes into account the tax paid in the various States in which economic activity is pursued and deducts it from overall income. [25] A tax exemption is thus granted Mr Gerritse on income earned in Germany, in accordance with the freedom to supply services. The exempted amount is then deducted from the tax payable on worldwide income.

36. Secondly, the Commission has demonstrated convincingly in its written observations [26] that application of the progressive scale provided for in German law to the income earned in Germany by Mr Gerritse would result in a rate comparable to the 25% flat rate that was applied in his case.

37. More specifically, the Commission calculates that in the case of Mr Gerritse, having regard to his net income and the tax scale under EStG 1996, the average tax rate would be 26.5%. The Commission rightly concludes that, at such a rate, discrimination cannot be said to obtain. In the case of Mr Gerritse, the 25% rate to which he is

23 — See the judgments, cited above, in *Schumacher* (paragraph 32) and *Gschwind* (paragraph 22).

24 — Paragraph 45 et seq.

25 — See the Netherlands' Government's replies to the questions put by the Court (p. 2).

26 — Point 27 et seq.

subject under EStG 1996 does not place him at a disadvantage in relation to a resident subject to the progressive scale.

38. It follows that the provision in German law imposing, in the present case, a flat rate of 25% does not infringe the Treaty provisions on the freedom to supply services.

B — On the deductibility of business expenses

39. It should be remembered, as a first point, that under EStG 1996 residents are assessed on the basis of net income after deduction of business expenses and non-residents on that of gross income with no deduction of such costs. [27]

40. In the second part of its question the national court making the reference seeks to ascertain whether national legislation which, as in the present case, taxes the income of a resident and that of a non-resident differently in so far as the former is taxed on his net income after deduction of business expenses while the latter is taxed on his gross income with no deduction of such costs is contrary to Article 59 of the Treaty.

41. I take the view that the German legislation at issue places Mr Gerritse at a real disadvantage.

42. I stressed earlier that in the area of direct taxation it is possible for a Member State to apply different rules to residents on the one hand and non-residents on the other. The rules applying to non-residents must not however place them, in the pursuit of their activity, at a disadvantage in the light of Community rules.

43. In this case, the disadvantage which Mr Gerritse claims to have suffered on account of the difference in treatment under German law is obvious. [28] As he is unable to deduct from his income the business and other expenses actually incurred in connection with his activity, Mr Gerritse is taxed on a higher amount than residents,

27 — The present case involves income with no deduction of business expenses. Paragraph 50(5)(4)(3) of EStG 1966 does, as we have seen, make provision for the reimbursement of business expenses but only where those expenses amount in aggregate to more than half the income.

28 — See also, in this connection, Molenaar, D., 'Obstacles for International Performing Artists', *European Taxation*, volume 42, issue 4, April 2002, p. 149, and in particular p. 150 and p. 151. The author draws attention to the official commentary on Article 17 of the Model Double Taxation Treaty drawn up by the Organisation for Economic Cooperation and Development (OECD) and the reference to the deduction of business expenses in the country in which the activity is exercised. The OECD is however, as the author points out, careful not to indicate how such deductions should be made. The author refers also to the view expressed by Professor Sandler at an IFA Congress in Cannes in 1995 that the non-deductibility of professional expenses constitutes a significant obstacle.

the latter being entitled, at the same level of income, to deduct their business expenses.

44. Furthermore, Mr Gerritse is unable subsequently to deduct the expenses concerned in his State of residence.

45. In these circumstances, I consider that it lies with German law, which, in accordance with the treaty concluded in order to avoid double taxation, is applicable to the taxation of the income earned by Mr Gerritse in Germany, to provide for the deduction of the business expenses incurred in earning the income concerned. In failing to make such provision, German legislation places Mr Gerritse at a disadvantage in relation to residents who engage in the same activity but are taxed only on their net income.

46. The disadvantage suffered by Mr Gerritse results from the difference in treatment brought about by German law, a difference based on the criterion of residence. Such a difference in treatment constitutes indirect discrimination.

47. It has to be considered whether this discrimination can be justified. As matters stand, the German Government has not intervened and the Finanzamt Berlin has not put forward arguments in defence of this discrimination arising out of German law.

48. As the referring court emphasises, the non-deductibility of the business expenses of non-residents cannot be justified in terms of the principle of 'cohesion of the tax system'. The need to safeguard the cohesion of a tax system has been recognised, in the judgments, cited above, in *Bachmann* and *Commission* v *Belgium*,[29] as being capable of justifying rules liable to restrict the fundamental freedoms guaranteed by the Treaty.

49. In this case, however, the German law providing for the income of a non-resident to be taxed at a flat rate of 25% does not in any way imply, even in terms of the cohesion of the tax system, that the income so taxed should be the non-resident's gross income.

50. It follows that the provisions of German income tax law which treat the income of a resident and that of a non-resident differently, taxing the net income of the former and the gross income of the latter, are contrary to Community law.

29 — See the judgments, cited above, in *Bachmann* (paragraphs 21 to 23) and *Commission* v *Belgium* (paragraphs 14 to 16).

V — Conclusion

51. I therefore propose that the Court should give the following answer to the national court's question:

(1) National legislation on income tax which, as in the present case, taxes the income of residents and that of non-residents differently, the former being taxed in accordance with a progressive scale incorporating a non-taxable basic allowance and the latter being taxed at a flat rate, is not contrary to Article 59 of the EC Treaty (now, after amendment, Article 49 EC).

(2) On the other hand, national legislation which, as in the present case, taxes the income of a resident and that of a non-resident differently in so far as the former is taxed on his net income after deduction of business expenses while the latter is taxed on his gross income with no deduction of such costs, is contrary to that Article.