JUDGMENT OF THE COURT (Third Chamber)

6 July 2006 *

In Case C-346/04,

REFERENCE for a preliminary ruling under Article 234 EC from the Bundesfinanzhof (Germany), made by decision of 26 May 2004, received at the Court on 12 August 2004, in the proceedings

Robert Hans Conijn

v

Finanzamt Hamburg-Nord,

THE COURT (Third Chamber),

composed of A. Rosas, President of the Chamber, J.-P. Puissochet, S. von Bahr, U. Lõhmus (Rapporteur) and A. Ó Caoimh, Judges,

* Language of the case: German.

Advocate General: P. Léger,
Registrar: R. Grass,

having regard to the written procedure,

after considering the observations submitted on behalf of:

— the German Government, by C.D. Quassowski and A. Tiemann, acting as Agents,

— the Commission of the European Communities, by R. Lyal and K. Gross, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 9 March 2006,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Article 52 of the EC Treaty (now, after amendment, Article 43 EC).

2 The reference was made in the context of a dispute between Mr Conijn and the Finanzamt Hamburg-Mitte-Altstadt, the duties of which were taken over by the Finanzamt Hamburg-Nord ('the Finanzamt') on 1 March 2005. Mr Conijn seeks acknowledgement of his right to deduct from his taxable income the costs which he incurred in obtaining tax advice for the purpose of preparing his tax return for income received in Germany as a person with restricted tax liability.

National law

3 Under the Einkommensteuergesetz (Income Tax Law), in its 1997 version ('the EStG 1997'), it is necessary to draw a distinction between persons with unrestricted income tax liability, residing in Germany, and persons with restricted tax liability, who do not reside in Germany but are taxable there on income received in that State.

4 Paragraph 15(1)(2) of the EStG 1997, which concerns income from industry, trade or business (Gewerbebetriebe), is worded as follows:

'1. Income from industry, trade or business (Gewerbebetriebe) means:

(1) ...

(2) profit shares paid to partners of an "offene Handelsgesellschaft", a "Kommanditgesellschaft" and any other form of partnership in which the partner is regarded as a person (jointly) carrying on the business and remuneration which a partner receives from the partnership for his activities in the service of the partnership, for loans granted to it or for assets made over to it. A partner who has an indirect share in the partnership through one or more partnerships shall be treated in the same way as a partner who has a direct share; he shall be regarded as a person jointly carrying on the business of the partnership in which he is an indirect partner if he himself and the partnerships through which he participates may be regarded as persons jointly carrying on the business of the partnership in which they participate directly.'

5 Paragraph 49(1)(2)(a) of the EStG 1997 states that income from industry, trade or business (Gewerbebetrieb) is taxable income.

6 Pursuant to Paragraph 50(1) of the EStG 1997, persons with restricted tax liability in Germany may not deduct costs incurred in obtaining tax advice as special expenditure, whereas persons with unrestricted tax liability may deduct such costs pursuant to Paragraph 10(1)(6) of the EStG 1997.

The main proceedings and the question referred

7 In 1998, Mr Conijn, a Netherlands national residing in the Netherlands, derived in Germany income from industry, trade or business (Gewerbebetrieb) amounting to

DEM 146 373.50 from a shareholding in a German limited partnership (Kommanditgesellschaft) which he had inherited as a joint heir. That sum accounted for less than 90% of his total income.

8 In his 1998 tax return, Mr Conijn deducted from his taxable income the sum of DEM 1 046, which he had incurred in obtaining tax advice for the purpose of preparing his tax return in Germany, as special expenditure pursuant to Paragraph 10(1)(6) of the EStG 1997. Relying on Paragraph 50(1) of the EStG 1997, the Finanzamt refused to allow a deduction of that expenditure.

9 Mr Conijn challenged that refusal before the Finanzgericht Hamburg (Hamburg Finance Court). That action was dismissed by judgment of 11 November 2003. Mr Conijn thus brought an appeal on a point of law ('Revision') against that judgment before the Bundesfinanzhof (Federal Finance Court), claiming that the judgment should be set aside and the costs of tax advice declared deductible. The Finanzamt contended that the appeal should be dismissed.

10 In those circumstances, the Bundesfinanzhof decided to stay proceedings and to refer the following question to the Court of Justice for a preliminary ruling:

'Is a situation whereby a national of another Member State with restricted tax liability in Germany, unlike a person with unrestricted tax liability, may not deduct from his total income as special expenditure the costs incurred by him in obtaining tax advice contrary to Article 52 of the Treaty ...?'

The question referred

11 The national court is asking in essence whether Article 52 of the Treaty precludes national legislation, such as that at issue in the main proceedings, which does not allow a person with restricted tax liability to deduct from his taxable income, as special expenditure, the costs incurred by him in obtaining tax advice for the purpose of preparing his tax return, in the same way as a person with unrestricted tax liability.

12 According to settled case-law, freedom of establishment for nationals of a Member State on the territory of another Member State includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings under the conditions laid down for its own nationals by the law of the State of establishment (see, in particular, Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 13; Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, paragraph 22; and Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 27).

13 Mr Conijn is taxed in Germany, under Paragraph 49 of the EStG, in respect of his income from industry, trade or business in that Member State. It seems that he is taxed directly in respect of that activity on profits made by the limited partnership and, under national tax law, he is regarded, on that basis, as a person carrying on business himself.

14 Although direct taxation falls within the competence of the Member States, the latter must none the less exercise that competence consistently with Community law (Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 16; Case C-35/98

Verkooijen [2000] ECR I-4071, paragraph 32; and Case C-422/01 *Skandia and Ramstedt* [2003] ECR I-6817, paragraph 25).

15 Thus, national tax law provisions must avoid any overt or covert discrimination on the basis of nationality (see, in particular, *Wielockx*, paragraph 16, and Case C-385/00 *De Groot* [2002] ECR I-11819, paragraph 75).

16 The fact, however, that a Member State does not grant to a non-resident certain tax benefits which it grants to a resident is not, as a rule, discriminatory having regard to the objective differences between the situations of residents and of non-residents, both from the point of view of the source of their income and from that of their personal ability to pay tax or their personal and family circumstances (Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 34, and Case C-391/97 *Gschwind* [1999] ECR I-5451, paragraph 23).

17 Moreover, for tax purposes, residence is the connecting factor on which current international tax law, in particular the Model Convention of the Organisation for Economic Cooperation and Development (OECD) (Model Convention on Double Taxation concerning Income and Capital, Report of the Tax Affairs Committee of the OECD, 1977, version of 29 April 2000), is as a rule founded for the purpose of allocating powers of taxation between States in situations involving extraneous elements.

18 In the present case, it is apparent from the case-file that Mr Conijn, who resides in the Netherlands, derived less than 90% of his total income in Germany.

19 The question thus arises whether the objective difference between the situation of a non-resident such as Mr Conijn and that of a resident serves as justification for national legislation, such as that at issue in the main proceedings, which does not grant deduction of the costs incurred in obtaining tax advice to the former, although the latter is entitled to deduct such costs as part of his tax return.

20 In relation to expenditure linked directly to the income of a person with restricted tax liability, the Court has held that, for expenditure such as business expenses linked with an activity in another Member State, a person with restricted tax liability must be treated in the same way as a person with unrestricted tax liability (see Case C-234/01 *Gerritse* [2003] ECR I-5933, paragraph 27).

21 As regards costs incurred in obtaining tax advice, the entitlement of persons with unrestricted tax liability to deduct them as 'special expenditure' is, in the view of the German Government, explained by the fact that those costs are made necessary by the complexity of national tax law.

22 Costs involved in obtaining tax advice, such as those at issue in the main proceedings, were incurred by Mr Conijn in preparing his tax return in respect of income derived in Germany. His duty to file a tax return results from the fact that he receives income in that Member State. Costs incurred in obtaining tax advice are therefore linked directly to the income taxed in that Member State, with the result that they affect in the same way the income received by all taxable persons whether resident or non-resident.

23 In addition, both resident and non-resident taxable persons are placed in a comparable situation as regards the complexity of national tax law. Thus, the right

to deduct, which seeks to compensate for expenses incurred in obtaining tax advice and is granted to taxable persons who are resident, must also be available to non-resident taxable persons who are faced with the same complexity of the national tax system.

24 In those circumstances, for the purpose of the possibility to deduct costs incurred in obtaining tax advice as special expenditure, resident and non-resident taxable persons are placed in a comparable situation and the national provision which refuses that possibility to non-residents constitutes a restriction prohibited by Article 52 of the Treaty.

25 Since no precise argument has been raised before the Court in justification of such a difference in treatment, it must be found that the national provision is likely to operate mainly to the detriment of nationals of other Member States and therefore entails indirect discrimination on grounds of nationality.

26 Consequently, the answer to the question referred must be that Article 52 of the Treaty precludes national legislation which does not allow a person with restricted tax liability to deduct from his taxable income, as special expenditure, the costs incurred by him in obtaining tax advice for the purpose of preparing his tax return, in the same way as a person with unrestricted tax liability.

Costs

27 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Third Chamber) hereby rules:

Article 52 of the EC Treaty (now, after amendment, Article 43 EC) precludes national legislation which does not allow a person with restricted tax liability to deduct from his taxable income, as special expenditure, the costs incurred by him in obtaining tax advice for the purpose of preparing his tax return, in the same way as a person with unrestricted tax liability.

[Signatures]