JUDGMENT OF THE COURT (Eighth Chamber)

18 January 2007 *

In Case C-104/06,

ACTION under Article 226 EC for failure to fulfil obligations, brought on 22 February 2006,

Commission of the European Communities, represented by L. Ström van Lier and R. Lyal, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Kingdom of Sweden, represented by A. Kruse, acting as Agent,

defendant,

* Language of the case: Swedish.

THE COURT (Eighth Chamber),

composed of E. Juhász, President of the Chamber, G. Arestis (Rapporteur) and J. Malenovský, Judges,

Advocate General: Y. Bot,
Registrar: R. Grass,

having regard to the written procedure,

having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,

gives the following

Judgment

1 By its application, the Commission of the European Communities seeks a declaration from the Court that, by adopting and maintaining in force tax legislation by virtue of which the deferral of taxation on capital gains realised on the sale of a residence occupied by its owner when he or she acquires a new residence is only granted where both the residence sold and the newly-acquired residence are situated on Swedish territory, the Kingdom of Sweden has failed to fulfil its obligations under Articles 18 EC, 39 EC, 43 EC and 56(1) EC and under Articles 28, 31 and 40 of the Agreement on the European Economic Area of 2 May 1992 (OJ 1994 L 1, p. 3, hereinafter 'the EEA Agreement').

Legal context

The EEA Agreement

2 Article 28 of the EEA Agreement provides:

'1. Freedom of movement for workers shall be secured among EC [European Community] Member States and EFTA [European Free Trade Association] States.

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

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

(a) to accept offers of employment actually made;

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

(c) to stay in the territory of an EC Member State or an EFTA State for the purposes of employment in accordance with the rules governing the employment of nationals of that State laid down by law, regulation or administrative action;

(d) to remain in the territory of an EC Member State or an EFTA State after having been employed there.

4. The provisions of this Article shall not apply to employment in the public service.

5. Annex V contains specific provisions on the free movement of workers.'

3 Article 31 of the EEA Agreement is worded as follows:

'1. Within the framework of the provisions of this Agreement, there shall be no restrictions on the freedom of establishment of nationals of an EC Member State or an EFTA State in the territory of any other of these States. This shall also apply to the setting-up of agencies, branches or subsidiaries by nationals of any EC Member State or EFTA State established in the territory of any of these States.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of Article 34, second paragraph, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of Chapter 4.

2. Annexes VIII to XI contain specific provisions on the right of establishment.'

National legislation

4 Chapter 47 of the law on income tax (1999:1229) (inkomstskattelagen (1999:1229), hereinafter 'the IL'), headed 'Deferral of taxation', contains provisions on the deferral of taxation on the sale of a private residential property or of a right to reside in a private cooperative property and the treatment of that deferral on subsequent sale.

5 Article 2 of Chapter 47 of the IL, on the conditions for deferral of taxation, provides:

'A taxpayer may benefit from a deferral of taxation where he or she:

(1) declares a capital gain on the sale of a previous residence,

(2) has acquired or intends to acquire a replacement residence and

(3) lives or intends to live in the replacement residence.'

6 Under Article 3, first paragraph, of Chapter 47 of the IL, previous residence means a private residence situated in Sweden which at the date of sale is the permanent residence of the taxpayer.

7 Article 5 of Chapter 47 of the IL, as amended by Law 2003:1206 (lagen om ändring i inkomstskattelagen 1999:1229), appears in the part of that chapter which is headed 'Replacement residence', and provides as follows:

'Replacement residence means an asset situated in Sweden and which, on purchase, comprises:

(1) a house with a parcel of land forming a residential unit,

(2) a house on land belonging to another,

(3) a house adapted for one or two families with its parcel of land within an agricultural unit,

(4) land on which a house such as that referred to in paragraphs 1 or 3 is being built, or

(5) housing in a private housing association.'

Pre-litigation procedure

8 The Commission considered that the provisions of Chapter 47 of the IL and, in particular, those of Articles 2 to 5 of that chapter, which make the deferral of taxation on capital gains arising from the sale of a private residential property or of a right to reside in a private cooperative property conditional on the purchase of a new residence (called a 'replacement residence') being on Swedish territory, infringe the Kingdom of Sweden's obligations under Articles 18 EC, 39 EC, 43 EC and 56(1) EC and under Articles 28, 31 and 40 of the EEA Agreement, and by letter dated 1 April 2004, gave that Member State formal notice to submit its observations.

9 Essentially, the Swedish authorities recognised that the system of deferral of taxation, such as that which results in particular from the application of the combined provisions of Articles 2 to 5 of Chapter 47 of the IL, represents an obstacle to the free movement of persons and capital. However, they considered that the provisions at issue are justified by overriding requirements in the general interest and, more particularly, the need to maintain the coherence of the national tax system.

10 Since it was not convinced by the arguments invoked by the Swedish authorities, the Commission issued a reasoned opinion on 5 July 2005 in which, firstly, it reiterated its complaint that the provisions of Chapter 47 of the IL in dispute undermine the free movement of both persons and capital and, secondly, it called upon the Kingdom of Sweden to adopt the measures necessary to comply with that opinion within a period of two months from its notification.

11 Since, in their reply to that reasoned opinion, the Swedish authorities essentially maintained their position that the provisions of Chapter 47 of the IL at issue are justified by the need to maintain the coherence of the national tax system, the Commission decided to bring the present action.

The action

12 It must be borne in mind, first of all, that, according to settled case-law, although direct taxation is a competence of the Member States, they must none the less exercise it consistently with Community law (see Case C-334/02 *Commission* v *France* [2004] ECR I-2229, paragraph 21, and Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 29).

13 It is necessary to examine whether, as the Commission submits, the provisions of Chapter 47 of the IL and, in particular, the combined provisions of Articles 2 to 5 of that chapter, represent restrictions on the free movement of persons and of capital enshrined in Articles 18 EC, 39 EC, 43 EC and 56(1) EC and in Articles 28, 31 and 40 of the EEA Agreement.

Free movement of persons

14 In connection with this complaint, the Commission submits that the Kingdom of Sweden has failed to fulfil its obligations under Articles 18 EC, 39 EC and 43 EC.

15 Article 18 EC, which sets out in general terms the right of every citizen of the Union to move and reside freely within the territory of the Member States, finds specific expression in Article 43 EC with regard to freedom of establishment and in Article 39 EC with regard to freedom of movement for workers (Case C-345/05 *Commission* v *Portugal* [2006] ECR I-10633, paragraph 13).

16 It is therefore necessary to consider, firstly, whether Articles 39 EC and 43 EC preclude national legislation such as that represented by the provisions of Chapter 47 of the IL in dispute.

17 The provisions of the Treaty on freedom of movement for persons are intended to facilitate the pursuit by Community nationals of occupational activities of all kinds throughout the Community, and preclude measures which might place Community nationals at a disadvantage when they wish to pursue an economic activity in the territory of another Member State (see Case C-464/02 *Commission* v *Denmark* [2005] ECR I-7929, paragraph 34 and the case-law cited).

18 Rules which preclude or deter a national of a Member State from leaving his country of origin in order to exercise his right to freedom of movement therefore constitute an obstacle to that freedom even if they apply without regard to the nationality of the workers concerned (see Case C-209/01 *Schilling and Fleck-Schilling* [2003] ECR I-13389, paragraph 25, and *Commission* v *Denmark*, paragraph 35).

19 It is clear from the case-law of the Court that, even if, according to their wording, the rules on freedom of movement for workers are intended, in particular, to ensure that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also preclude the State of origin from obstructing the freedom of one of its nationals to accept and pursue employment in another Member State (Case C-385/00 *De Groot* [2002] ECR I-11819, paragraph 79).

20 The same also applies to the rules concerning freedom of establishment. According to the case-law, even if, according to their wording, those rules are intended to ensure 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 (Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 42, and Case C-471/04 *Keller Holding* [2006] ECR I-2107, paragraph 30).

21 In the present case, even though the provisions of Chapter 47 of the IL in dispute do not prevent a person liable to income tax in Sweden from pursuing employment in another Member State or generally exercising his right of establishment, they are none the less likely to restrict the exercise of those rights by having, at the very least, a deterrent effect on taxable persons wishing to sell their real property in order to settle in a Member State other than the Kingdom of Sweden.

22 It is clear that a taxable person who decides to sell a residential property that he owns in Sweden in order to transfer his residence to another Member State and to purchase a new property there for the purposes of his accommodation is, in the exercise of the rights conferred by Articles 39 EC and 43 EC, subject to less favourable tax treatment than that enjoyed by a person who maintains his residence in Sweden.

23 That difference in treatment in relation to the deferral of taxation of capital gains realised may affect the assets of a taxable person who wishes to transfer his residence outside Sweden and, as a consequence, is likely to deter him from proceeding with such a transfer.

24 It follows that, by making entitlement to the deferral of taxation on capital gains arising from the sale of a private residential property or of a right to reside in a private cooperative apartment conditional on the new residence being on Swedish territory, the combined provisions of Chapter 47 of the IL, and in particular Articles

2 to 5 of that chapter, are liable to impede freedom of movement for workers and freedom of establishment, as guaranteed by Articles 39 EC and 43 EC.

25 According to well-established case-law, however, national measures which are liable to hinder the exercise of fundamental freedoms guaranteed by the Treaty or make it less attractive may nevertheless be allowed if they pursue a legitimate objective in the public interest, are appropriate to ensuring the attainment of that objective, and do not go beyond what is necessary to attain the objective pursued (see, *De Lasteyrie du Saillant*, paragraph 49, and Case C-470/04 *N* [2006] ECR I-7409, paragraph 40).

26 Moreover, whilst the Court has recognised that the need to maintain the coherence of a tax system can justify a restriction on the exercise of the fundamental freedoms guaranteed by the Treaty, for an argument based on such a justification to succeed, a direct link must be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy (see, to that effect, *Keller Holding*, paragraph 40 and the case-law cited).

27 However, in the present case, not only does the Kingdom of Sweden not advance any specific arguments before the Court seeking to establish that the provisions of the IL in dispute are justified by the need to ensure coherence of the tax system concerning the deferral of taxation on capital gains, but, moreover, in its defence, it admits the failure to fulfil obligations of which it is accused. Further, it submits that, in order to fulfil its obligations under Community law, it is studying a reform of the complex rules on deferral of taxation.

28 According to the case-law, whether a Member State has failed to fulfil its obligations must be determined by reference to the situation prevailing in the Member State at

the end of the period laid down in the reasoned opinion, and the Court cannot take account of any subsequent changes (see, inter alia, Case C-388/02 *Commission* v *Ireland* [2003] ECR I-12173, paragraph 6).

29 In those circumstances, the provisions of Chapter 47 of the IL in dispute must be held to be contrary to Articles 39 EC and 43 EC.

30 Secondly, with regard to persons who are not economically active, the same conclusion applies, for the same reasons, to the complaint relating to Article 18 EC.

31 The Commission also claims that the Kingdom of Sweden has failed to fulfil its obligations under Articles 28 and 31 of the EEA Agreement, relating respectively to freedom of movement for workers and freedom of establishment.

32 It is to be noted, in the present case, that the rules prohibiting restrictions on the freedom of movement and the freedom of establishment laid down in Articles 28 and 31 of the EEA Agreement are essentially identical to those established by Articles 39 EC and 43 EC.

33 Therefore, in the light of the conclusion reached in paragraph 29 of the present judgment, the provisions of Chapter 47 of the IL in dispute are also contrary to Articles 28 and 31 of the EEA Agreement.

34 The Commission's action must accordingly be considered to be well founded as far as the complaint alleging infringement of the rules on freedom of movement for persons in the EEA Agreement is concerned.

35 It must therefore be held that, by adopting and maintaining in force tax rules, such as those in Chapter 47 of the IL, which make entitlement to deferral of taxation on capital gains arising from the sale of a private residential property or of a right to reside in a private cooperative building conditional on the newly-acquired residence also being on Swedish territory, the Kingdom of Sweden has failed to fulfil its obligations under Articles 18 EC, 39 EC and 43 EC and under Articles 28 and 31 of the EEA Agreement.

Free movement of capital

36 In addition, the Commission seeks a declaration from the Court that the Kingdom of Sweden has failed to fulfil its obligations under Article 56(1) EC and Article 40 of the EEA Agreement.

37 Since the provisions of the Treaty and the EEA Agreement on freedom of movement for persons preclude the contested legislation, there is no need for a separate examination of that legislation in the light of Article 56(1) EC and Article 40 of the EEA Agreement concerning the free movement of capital (see *Commission* v *Portugal*, paragraph 45).

Costs

38 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs, if they have been applied for in the successful party's pleadings. Since the Commission has applied for the Kingdom of Sweden to be ordered to pay the costs and the latter has been unsuccessful, it must be ordered to pay the costs.

On those grounds, the Court (Eighth Chamber) hereby:

1. **Declares that, by adopting and maintaining in force tax provisions, such as those in Chapter 47 of the law on income tax (1999:1229) (inkomstskattelagen (1999:1229)), which make entitlement to deferral of taxation on capital gains arising from the sale of a private residential property or of a right to reside in a private cooperative property conditional on the newly-acquired residence also being on Swedish territory, the Kingdom of Sweden has failed to fulfil its obligations under Articles 18 EC, 39 EC and 43 EC and under Articles 28 and 31 of the EEA Agreement;**

2. **Orders the Kingdom of Sweden to pay the costs.**

[Signatures]