Reports of Cases

OPINION OF ADVOCATE GENERAL
MENGOZZI
delivered on 18 November 2014[1]

Case C-559/13

Finanzamt Dortmund-Unna
v
Josef Grünewald

(Reference for a preliminary ruling from the Bundesfinanzhof (Germany))

(Free movement of capital — Direct taxation — Income tax — Deductibility of payments made to a parent in the context of an anticipated succession — Exclusion of non-resident taxpayers)

1. By the present request for a preliminary ruling, referred by the Bundesfinanzhof (Germany) (Federal Finance Court or 'the referring court'), the Court is again asked to determine the compatibility with the provisions of EU law on the free movement of capital of national legislation under which only resident taxpayers have the right to deduct from their taxable income support payments made following a transfer of assets by way of anticipated succession.

2. The request for a preliminary ruling has arisen in the course of a dispute between Mr Grünewald, a natural person who is not resident in Germany, and the German tax authority which refused to allow Mr Grünewald to deduct from the income he had generated in Germany the support payments he had made to his parents in the context of a transfer, by way of anticipated succession, of shares in a partnership operating in the fruit and vegetable sector.

3. The question of the compatibility of the national tax legislation at issue with EU law on the free movement of capital has in fact previously been drawn to the Court's attention. Indeed, in its judgment in *Schröder*,[2] the Court held to be incompatible with EU law a provision of national law which discriminated between residents and non-residents in relation to the possibility of deducting the annuities paid to a relative, in the context of a transfer of assets by way of anticipated succession, in so far as the undertaking to pay those annuities resulted from the transfer of that property.

4. However, for a number of reasons — set out in the order for reference and which I shall analyse below — the Bundesfinanzhof harbours doubts as to whether the approach adopted by the Court in *Schröder* definitively clarified the position in terms of EU law and can therefore provide a comprehensive answer to the legal question at issue in the dispute before it. The Bundesfinanzhof also wonders whether there may not be overriding reasons in the public interest which are capable of justifying the national legislation at issue. In those circumstances, it therefore decided to refer the matter to the Court once again, by the present reference for a preliminary ruling.

1 — Original language: Italian.
2 — C-450/09, EU:C:2011:198.

I – German law

5. Although it has already been set out in the context of *Schröder*,[3] I consider it necessary to describe the relevant German law in detail below, since both the Bundesfinanzhof and the German Government contend that the national law was inadequately described in the order for reference which led to the preliminary ruling in *Schröder* and that this might have influenced the Court's approach in that case. I shall therefore set out the relevant legal framework for income tax; then the arrangements for anticipated succession; and, lastly, the tax treatment of transfers of assets by way of anticipated succession.

6. As regards, first, the relevant legal framework for income tax, it must be pointed out that the German law on income tax (the Einkommensteuergesetz; 'the EStG'),[4] draws a distinction between taxpayers who have their domicile or habitual residence in Germany and those who do not. The former are subject to unlimited income tax liability, whereas the latter have only limited tax liability, covering only income earned in Germany. The income on which taxpayers with limited liability are required to pay income tax includes income deriving from the exercise of an industrial or commercial activity in Germany.[5]

7. Under Paragraph 10(1) of the EStG, annuities and permanent burdens based on particular obligations may, in certain circumstances, be deducted as 'special expenditure', provided that they are neither business expenses nor operational expenses.[6]

8. Paragraph 50 of the EStG lays down specific provisions concerning persons with limited tax liability. Under Paragraph 50(1), persons with limited tax liability may deduct business expenses or occupational expenses only to the extent that those expenses are economically linked to income of German origin. On the other hand, such taxpayers are not covered by Paragraph 10 of the EStG and, consequently, may not deduct special expenditure.

9. Secondly, anticipated succession in German law involves a transfer of assets whereby, with a view to a future succession, one or more testators transfer their assets — in particular, their company or immovable property — to one or more future heirs. Typically, in the context of a transfer of that nature, the transferor reserves sufficient resources to support himself, which may take the form of periodic annuities ('private support payments'). German case-law has determined that the rationale underlying the anticipated succession mechanism is the idea that it makes it possible for members of the next generation to benefit, prior to succession, from an income-producing economic unit enabling them to provide, at least partly, for their material needs, while still ensuring the subsistence of the transferor.[7] According to the Bundesfinanzhof, through the transfer of assets by way of anticipated succession, the transferor reserves to himself, in the form of recurrent annuities, income which really comes from his own estate, but which must henceforth be generated by the transferee.

10. In an agreement for the transfer of assets by way of anticipated succession, which case-law categorises as a gift, the amount of the annuity is determined not on the basis of the value of the assets transferred, but on the basis of the transferor's personal needs and the debtor's ability to pay.[8] That feature distinguishes an agreement of that kind from transfers of assets for consideration involving reciprocal obligations, in which any recurring payments that have been agreed actually constitute the financial consideration for the assets transferred.

3 — See paragraphs 5 to 7 of the judgment in *Schröder* (EU:C:2011:198), as well as paragraphs 13 to 23 of the Opinion of Advocate General Bot in that case, EU:C:2010:761.

4 — In the version in force at the material time, BGBl. 2002 I, p. 4210.

5 — See Paragraphs 1 and 49 of the EStG.

6 — As defined in Paragraphs 4 and 9 of the EStG respectively.

7 — Judgments of the Bundesfinanzhof of 5 July 1990, GrS 4/89 to 6/89, C.II.1.C, and of 12 May 2003, GrS 1/00, paragraph C.II.3.

8 — Judgment of the Bundesfinanzhof of 5 July 1990, GrS 4/89 to 6/89, paragraph C.I.1.

11. As regards, thirdly, the tax treatment of transactions involving the transfer of assets by way of anticipated succession where it is agreed that the transferee will provide the transferor with private support payments, it is settled case-law of the Bundesgerichtshof that such payments are not regarded as either the consideration for the disposal or the acquisition expenses of the transferee, but are in fact classified, for tax purposes, as special expenditure and recurring receipts.[9] That classification is based on the rationale underlying the anticipated succession mechanism, as described in point 9 above. Under Paragraph 10 of the EStG, in the case of resident taxpayers, since private support payments constitute special expenditure, they are fully deductible as a permanent burden for the purposes of determining taxable income, provided that they are capable of subsequent accounting adjustment. Non-resident taxpayers may not, however, deduct such payments, since Paragraph 50 of the EStG specifically excludes taxpayers with limited income tax liability from the scope of Paragraph 10.

12. Again because of the rationale underlying the anticipated succession mechanism, as described in point 9 above, in accordance with which reserving the right to revenue in the form of recurring payments to the transferor results in a 'transfer of the ability to pay tax',[10] the deduction of the private support payments by the transferee/debtor is matched by the imposition of tax on those payments, as 'other income', which is payable by the transferor/creditor with full tax liability (the 'Korrespondenzprinzip').

II – **The facts, the main proceedings and the question referred for a preliminary ruling**

13. By transfer agreement of 17 January 1989, in the context of a transfer of assets by way of anticipated succession, Mr Grünewald, the respondent before the national court, and his brother each acquired from their father a 50% share in a partnership under civil law operating in the fruit and vegetable sector. Under the agreement, the brothers undertook to make private support payments to their father or parents, according to the terms set out in the transfer agreement.

14. Between 1999 and 2002, Mr Grünewald, who is neither domiciled nor habitually resident in the Federal Republic of Germany, but resides in another Member State of the European Union, was in receipt of income from a commercial activity on the basis of his shareholding. During the same period, he was also in receipt of other income in Germany.

15. On the view that Mr Grünewald had limited liability for income tax, the Finanzamt Dortmund-Unna (Dortmund-Unna Tax Office; 'the Finanzamt'), the appellant before the referring court, refused, on the basis of Paragraph 50 of the EStG, to allow Mr Grünewald to deduct the private support payments made to his father.

16. Mr Grünewald contested the Finanzamt's decision before the Finanzgericht Münster (Münster Finance Court), which upheld the action. The Finanzamt consequently brought an appeal on a point of law before the Bundesfinanzhof, seeking to have the judgment of the Finanzgericht Münster set aside and the action brought by Mr Grünewald before the Finanzgericht Münster dismissed.

17. The referring court points out that, on the basis of the applicable national law, the Finanzamt was right to refuse to allow Mr Grünewald to deduct the private support payments at issue, as they constitute special expenditure which may not be deducted by a person with limited tax liability such as Mr Grünewald. Citing the abovementioned judgment in *Schröder*, however, the referring court noted that doubts remain regarding the compatibility with EU law of a tax regime of that kind.

9 — Judgments of the Bundesfinanzhof of 5 July 1990, GrS 4/89 to 6/89, paragraph C.II.1.C, and of 12 May 2003, GrS 1/00, paragraph C.II.1.C.

10 — Judgment of the Bundesfinanzhof of 31 March 2004, X R 66/98, paragraph II.3, and the case-law cited.

18. The Bundesfinanzhof sets out in particular a number of doubts concerning the applicability of the judgment in *Schröder* to the case pending before it. In the first place, according to the Bundesfinanzhof, the order for reference in *Schröder* failed properly to emphasise the existence within the national tax regime of the abovementioned 'Korrespondenzprinzip'[11] whereby a deduction for the payer of the support payments is matched by taxation for the recipient. In the second place, the tax authorities take the view that, in its judgment in *Schröder*, the Court gave a ruling only in the context of a transfer for value, which cannot be assumed to exist in the case of a transfer by way of anticipated succession. Furthermore, in such a case, the payment of any annuities would not be wholly deductible but would have to be divided into acquisition costs (deductible *pro rata*) and interest (immediately deductible). In the third place, the judgment in *Schröder* concerned rental income of a private nature and not, as in the present case, revenue from a jointly operated business undertaking.

19. The Bundesfinanzhof therefore identifies two important issues requiring analysis in the light of EU law. On the one hand, it expresses doubts regarding the finding of the Finanzgericht Münster that there is a direct link between the commercial income obtained from the shareholding in the partnership and the private support payments made by Mr Grünewald. In its view, the Finanzgericht failed to take into account that the private support payments were designed to meet the need for support of the recipients (namely, the applicant's parents), a fact that makes it possible to classify them as personal to the applicant. Moreover, the national court wonders whether the legislation at issue might not be justified by the principle of territoriality, that is to say, the need to safeguard the balanced allocation of taxation powers between the Member States.

20. In the light of those considerations, the national court deemed it necessary, by order of 14 May 2013, to stay the proceedings pending before it and to refer the following question to the Court for a preliminary ruling:

'Does Article 63 of the Treaty on the Functioning of the European Union (TFEU) preclude legislation of a Member State under which private support payments by non-resident taxable persons which are connected with a transfer of revenue-producing domestic assets in the course of an "anticipated succession" are not tax deductible, whereas such payments are deductible in the case of full liability to taxation, but the deduction results in a corresponding tax liability for a (fully taxable) recipient of the payments?'

III – **Procedure before the Court**

21. The order for reference was received at the Court Registry on 30 October 2013. Written observations have been submitted by the German and French Governments, and by the European Commission. At the hearing on 16 September 2014, oral argument was presented by the Finanzamt, by the German and French Governments, and by the Commission.

22. By letter of 18 February 2014, the German Government submitted a request on the basis of the third paragraph of Article 16 of the Statute of the Court for the present case to be heard by the Court sitting in the Grand Chamber formation.

11 — See point 12 above.

IV – **Legal analysis**

23. By its question, the Bundesfinanzhof asks, in essence, whether Article 63 TFEU must be construed as precluding legislation of a Member State under which resident taxpayers, but not non-resident taxpayers, may deduct private support payments connected with the transfer, by way of anticipated succession, of revenue-producing domestic assets and the deduction gives rise to a corresponding tax liability for the recipient of those payments with full tax liability in that State.

A – *The relevant freedom of movement*

24. It must first be pointed out that Article 63(1) TFEU generally prohibits all restrictions on the movement of capital between Member States.

25. In the absence of a definition of 'movement of capital' in the Treaty, the Court has recognised the nomenclature in Annex I to Directive 88/361 as being of indicative value, it being understood that, as is stated in the introduction to that annex, the list set out therein is not exhaustive. [12]

26. In that regard, it is settled case-law that gifts and inheritances falling under Section XI of Annex I to Directive 88/361 constitute movements of capital for the purposes of Article 63 TFEU, with the exception of cases in which all the constituent elements are confined within a single Member State. [13] It follows that, apart from those specific cases, the tax treatment of inheritances or gifts — whether gifts of money, immovable property or movable property — falls within the scope of the TFEU provisions on the movement of capital. [14]

27. It must also be observed that the Court recognised in its judgment in *Schröder* that transfers of assets by way of anticipated succession, which are of a cross-border nature, come within the scope of Article 63 TFEU. [15] The fact that, in the present case, the transfer by way of anticipated succession consists in the transfer of shares in a partnership and not of immovable assets, as in the case which gave rise to the judgment in *Schröder*, is not of itself, in my view, capable of altering the conclusion concerning the freedom of movement applicable to the national legislation at issue. [16]

12 — See *Welte*, C-181/12, EU:C:2013:662, paragraph 19.

13 — See *Welte*, EU:C:2013:662, paragraph 20 and the case-law cited, as well as *Schröder*, EU:C:2011:198, paragraph 26.

14 — *Commission* v *Spain*, C-127/12, EU:C:2014:2130, paragraph 53, and *Mattner*, C-510/08, EU:C:2010:216, paragraph 20 and the case-law cited.

15 — In *Schröder* (EU:C:2011:198, paragraph 27), the Court held that the transfer of immovable property located in a Member State by means of anticipated succession to a natural person resident in another Member State comes within the scope of Article 63 TFEU.

16 — In that connection, in fact, the Court has already pointed out that the transfer of holdings in a resident company between a resident and a non-resident investor constitutes a movement of capital (see, to that effect, *Glaxo Wellcome*, C-182/08, EU:C:2009:559, paragraph 43). Moreover, the question of the application of freedom of establishment within the meaning of Article 49 TFEU, to which, inter alia, none of the intervening parties has referred, does not, in my view, arise in the present case. Indeed, according to well-established case-law, to establish whether national legislation falls within one or other of the freedoms of movement, the purpose of the legislation concerned must be taken into consideration (see *Test Claimants in the FII Group Litigation*, C-35/11, 2012:707, paragraph 90 and the case-law cited). It is clear that the national legislation at issue concerns the tax treatment of the private support payments due in the context of a transaction by way of anticipated succession, and more particularly the possibility of deducting those payments as 'special expenditure', regardless of whether or not the subject of the transaction was the transfer of shares in a company (that element distinguishes the tax legislation at issue from the legislation at issue in *Scheunemann*, C-31/11, EU:C:2012:481, see paragraph 21 in particular). Consequently, in the light of its purpose, even accepting that the legislation at issue may have restrictive effects on the freedom of establishment, particularly where the subject-matter of the transfer by way of anticipated succession consists of shareholdings which make it possible to exert a definite influence over a company's decisions and determine its activities, those effects are simply the unavoidable consequence of any restriction on the free movement of capital and, therefore, do not justify an independent examination of that legislation in the light of Article 49 TFEU (see, to that effect, *Glaxo Wellcome* EU:C:2009:559, paragraph 51 and the case-law cited). It should also be pointed out, among other things, that, in the present case, it is not clear from the order for reference what role in the management of the partnership is conferred by the shareholdings transferred.

28. A situation in which a person resident in Germany transfers, by way of anticipated succession, to one of his children who is resident in another Member State shares in a partnership governed by German law and active in the agricultural sector in Germany constitutes a transaction involving cross-border elements and falls, in principle, within the category of 'movement of capital' for the purposes of Article 63 TFEU.

B – *The existence of a restriction on the free movement of capital*

29. It must then be noted that the measures prohibited by Article 63(1) TFEU, as restrictions on the movement of capital, include, in particular, those which are liable to discourage non-residents from making investments in a Member State or from maintaining such investments [17] or of discouraging residents of a Member State from doing so in other States. [18]

30. Under the legislation at issue in the main proceedings, a natural person who is not domiciled or habitually resident in Germany is liable, under Paragraph 49 of the EStG, to income tax in that Member State in respect of income derived from the exercise of an industrial or commercial activity in Germany. [19] By contrast with a resident taxpayer, however, a non-resident taxpayer may not, pursuant to Paragraph 50 of the EStG, deduct from that income — as special expenditure within the meaning of Paragraph 10(1) of the EStG — private support payments, such as those made by Mr Grünewald to his father or parents, in the course of anticipated succession.

31. The less favourable tax treatment accorded to non-residents in relation to private support payments could discourage the latter from acquiring, by way of anticipated succession, or from maintaining, shareholdings in German companies engaged in industrial or commercial activities in Germany. [20] It could also discourage German residents from designating as beneficiaries of an anticipated succession persons resident in a Member State other than the Federal Republic of Germany. [21]

32. It follows from the above considerations that legislation which discriminates against non-resident taxpayers constitutes a restriction on the free movement of capital, which is, in principle, prohibited by Article 63 TFEU.

C – *Whether there is any justification for the restriction on the free movement of capital*

33. However, it is necessary to establish whether, despite constituting a restriction on the free movement of capital, national tax legislation, such as that at issue in the main proceedings, may be deemed to be compatible with the provisions of the FEU Treaty on the free movement of capital.

34. In fact, Article 65(1)(a) TFEU states that the provisions of Article 63 'shall be without prejudice to the right of Member States ... to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence ...'. However, since it derogates from the fundamental principle of the free movement of capital, that

17 — *Halley*, C-132/10, EU:C:2011:586, paragraph 22 and the case-law cited, and *Schröder* EU:C:2011:198, paragraph 30.

18 — *Commission* v *Finland*, C-342/10, EU:C:2012:688, paragraph 28, and *Commission* v *Germany*, C-600/10, EU:C:2012:737, paragraph 14.

19 — See, with reference to income deriving from the letting of immovable property, *Schröder*, EU:C:2011:198, paragraph 31.

20 — See, by analogy, in relation to the acquisition of immovable property *Schröder*, EU:C:2011:198, paragraph 31. As regards being discouraged from acquiring shares in companies, see *Haribo Lakritzen Hans Riegel*, C-436/08 and C-437/08, EU:C:2011:61, paragraphs 52 and 53, and *Glaxo Wellcome* EU:C:2009:559, paragraphs 57 and 58.

21 — See *Schröder*, EU:C:2011:198, paragraph 32.

provision must be narrowly construed and is itself limited by Article 65(3) TFEU, under which the national provisions referred to in Article 65(1) 'shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63 [TFEU]'. [22]

35. It is therefore necessary to determine whether national legislation such as that at issue, which draws a distinction between resident and non-resident taxpayers, involves unequal treatment permitted under Article 65(1)(a) TFEU, or constitutes arbitrary discrimination or a disguised restriction prohibited by Article 65(3). In that context, it is clear from settled case-law that national legislation of that nature may be regarded as compatible with the provisions on the free movement of capital in two cases only: where the difference in treatment concerns situations which are not objectively comparable or where it is justified by an overriding reason in the public interest. [23]. In order to be justified, moreover, the difference in treatment must not go beyond what is necessary in order to attain the objective of the legislation in question. [24]

1. The comparability of the situations at issue

36. It is clear from a line of authority dating back to the judgment in *Schumacker* [25] that, in relation to direct taxes, the situations of residents and of non-residents are generally not comparable, because the income received in the territory of a Member State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence, and because a non-resident's personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is easier to assess at the place where his personal and financial interests are centred, which in general is the place where he has his usual abode. [26]

37. Consequently, the fact that a Member State does not grant certain tax benefits to non-residents is not, as a rule, regarded as discriminatory in case-law. [27]

38. Accordingly, a non-resident taxpayer is not, in principle, in a position to reproach the Member State in which he receives only a small part of his income for not granting him a tax benefit that depends on his personal and family situation, such as the deduction of an annuity towards personal needs which he is obliged to pay, since to make such a determination is the responsibility of the Member State where he resides. The State in which the income originated is not required to take account of the personal and family situation of a non-resident taxpayer unless the taxpayer derives all or almost all of his taxable income in that State. [28]

39. However, it is also clear from settled case-law that, in relation to expenses, such as business expenses which are directly linked to an activity which has generated taxable income in a Member State, residents and non-residents of that State are in a comparable situation and, accordingly, legislation of that State which denies non-residents the right to deduct such expenses, in matters of taxation, but allows residents to do so, risks placing at a disadvantage primarily nationals of other Member States and therefore constitutes indirect discrimination on grounds of nationality. [29]

22 — See *Commission* v *Germany*, C-211/13, EU:C:2014:2148, paragraphs 45 and 46, and *Welte*, EU:C:2013:662, paragraphs 42 and 43 and the case-law cited.

23 — *Commission* v *Finland*, C-342/10, EU:C:2012:688, paragraph 35 and the case-law cited.

24 — *Schröder*, EU:C:2011:198, paragraph 35 and the case-law cited, and *Commission* v *Germany* EU:C:2014:2148, paragraph 47.

25 — C-279/93, EU:C:1995:31.

26 — *Schumacker*, EU:C:1995:31, paragraphs 31 and 32, and *Schröder*, EU:C:2011:198, paragraph 37 and the case-law cited.

27 — Having regard to the objective differences between the situation of residents and that of non-residents, from the point of view both of the source of their income and of their personal ability to pay tax or their personal and family circumstances. See *Schröder*, EU:C:2011:198, paragraph 38 and the case-law cited.

28 — *Schumacker*, EU:C:1995:31, paragraph 32. See also the Opinion of Advocate General Bot in *Schröder*, EU:C:2010:761, paragraphs 44 and 45.

29 — *Commission* v *Finland*, EU:C:2012:688, paragraph 37, and *Schröder*, EU:C:2011:198, paragraph 40 and the case-law cited.

40. In the light of the principles established by case-law and set out in the preceding points, it is necessary to determine whether or not the situation of a non-resident taxpayer, like Mr Grünewald, who makes private support payments in the context of a transfer of shares by way of anticipated succession, is comparable with that of a resident taxpayer, such as Mr Grünewald's brother, who, on the same basis, receives the same assets and makes the same private support payments.

41. It must first be noted in that regard that, in the present case, it is not clear from the order for reference what portion of Mr Grünewald's total income is accounted for by the income he received in Germany during the tax periods at issue.

42. Were the national court to establish that, during those periods, Mr Grünewald earned most of his aggregate income in Germany, it would have to be concluded that his situation was comparable to that of a resident taxpayer and, accordingly, differing tax treatment in relation to the deduction of the private support payments would not, in principle, be permissible.

43. If, however, the national court were to establish that the income obtained in Germany by Mr Grünewald did not constitute the bulk of his aggregate income, then his situation would be comparable to that of a resident taxpayer if the private support payments he made had to be classified as expenses directly linked to the activity which generated the taxable income, in accordance with the case-law cited in point 39 above.

44. It must be noted in that regard that operating expenses directly connected to the income received in the Member State in which the activity is pursued must be understood as expenses which have a direct economic connection to the provision of services which gave rise to taxation in that State and which are therefore inextricably linked to those services, such as travel and accommodation costs. [30]

45. In *Schröder*, the Court specifically found that, to the extent that the undertaking to pay the annuity arises as a result of the transfer to the person concerned of the immovable property at issue (which is a matter for the referring court to establish), that annuity constitutes an expense directly linked to the use of that property, with the result that the taxpayer is, in that regard, in a situation comparable to that of a resident taxpayer. [31]

46. Applied to the present case, that criterion requires that, should the referring court establish, as would appear to be the case, [32] that the obligation incumbent on Mr Grünewald to make the private support payment derives from the transfer to him, by way of anticipated succession, of the shares in the partnership which generate, in part at least, the taxable income in Germany, then that income would be classified as expenses directly linked to the activity which generated the taxable income, and Mr Grünewald's situation would have to be regarded as comparable with that of a resident taxpayer, such as his brother.

47. However, in its order for reference, the Bundesfinanzhof cites a number of reasons, mentioned in point 18 above, which, in its view, cast doubt on the applicability to the present case of the approach adopted in *Schröder*. I fail to find any of those reasons persuasive.

48. The Bundesfinanzhof first mentions possible gaps in the order for reference which gave rise to the ruling in *Schröder*, which, in its view, failed, in particular, to draw attention to the 'principle of correspondence' [33] as between the deduction of the payments in the case of the debtor and their taxation in the case of the recipient. In that regard, I believe, in common with the Commission, that, even accepting that the description of the national legal framework referred to the Court in *Schröder*

30 — See *Centro Equestre da Lezíria Grande*, C-345/04, EU:C:2007:96, paragraph 25.

31 — See *Schröder*, EU:C:2011:198, paragraph 46.

32 — See point 59 below.

33 — Namely, the 'Korrespondenzprinzip' mentioned in point 12 above.

was incomplete and that the Court failed, through its internal research services, to notice this, a failure to refer to the 'Korrespondenzprinzip' does not change the analysis of the discriminatory tax treatment accorded to the non-resident taxpayer. That principle actually plays no part in the classification of the private support payments as 'expenses directly linked' to the activity which generated the taxable income, in accordance with the case-law cited in the preceding points. In addition, there is no reason — and, without prejudice to the considerations pertaining to overriding reasons in the public interest set out in point 66 et seq. below, neither the referring court nor the German Government invokes any such reason — to consider that the tax treatment of the private support payments as far as the recipient is concerned will give rise to different tax treatment for the debtor of the payments, depending on whether or not the latter is a resident taxpayer.

49. As regards, secondly, the argument of the German tax authorities to which the Bundesfinanzhof refers, according to which, in *Schröder*, the Court gave a ruling only in the context of a transfer for value, and not a transfer by way of anticipated succession, and that, accordingly, in a case like *Schröder*, the distinction between the deduction of the acquisition costs and of the interest costs would be significant, I find that argument rather surprising. In fact, just from reading the Court's judgment in *Schröder* and the Opinion of Advocate General Bot in that case, there seems to be no doubt that in that judgment, as in this case, the Court was dealing with a transfer by way of anticipated succession which was not for valuable consideration.[34] Moreover, the German Government itself clearly stated at the hearing that, on the facts, the two cases were similar.

50. Thirdly, as far as the doubts of the Bundesfinanzhof regarding the source of the taxable income are concerned, I consider it irrelevant to the analysis under EU law that the subject-matter of the transfer by way of anticipated succession in the present case consists in the shares in a partnership which pursues an economic activity and not, as in *Schröder*, immovable property. Both cases actually involve the transfer of assets which generate taxable income in Germany, and the fact that the income derives from a commercial activity rather than from the letting of property does not give rise to any difference in their tax treatment for the purposes of the present case, particularly with regard to the difference in the tax treatment of non-resident taxpayers.

51. In its order for reference, the Bundesfinanzhof appears to reproach the Finanzgericht for failing to take into account that the private support payments are intended to ensure that the basic needs of the recipients are met, a factor that would enable those payments to be classified as falling within the transferee's personal sphere, so that they ought to be taken into account by that person's State of residence, without the State in which the income is generated being required to allow deduction.[35]

52. In its observations, the German Government also contends that the private support payments must be classified, as in German law, as deductions of a personal nature, as they are based on family ties.[36] It maintains that this classification of the private support payments in national law should also be pivotal when it comes to assessing the tax treatment of the payments under EU law. In the absence of harmonisation of direct taxation systems, it ought in fact to be for the legislature and national courts to determine the legal nature of the tax deductions.

34 — See paragraphs 9 and 12 and also paragraphs 42 and 43 of the judgment in *Schröder*, EU:C:2011:198, and, clearlier still, points 20 to 23 of the Opinion of Advocate General Bot in that case (EU:C:2010:761).

35 — See case-law cited in footnote 25.

36 — The German Government argues, in particular, that the personal nature of the private support payments derives from the nature of the kind of agreement that falls within family or inheritance law; from the purpose of the transfer which is to secure financially the parents who are getting older; from the fact that the payment is not evaluated according to value of the consideration but according to the recipient's personal needs and the ability of the debtor of the payments to pay tax; and from the fact that the parties are driven by the concept of retaining within the family the productive activity which has been transferred.

53. On that point, as regards the fact highlighted by the Bundesfinanzhof that the private support payments are intended to ensure that the recipient's basic needs are met, the Court rejected, in its judgment in *Schröder*, similar arguments put forward by the German Government and established that that fact did not call into question the existence of a direct link within the meaning of the case-law, since it derives not from a correlation between the amount of the expenditure in question and that of the taxable income, but from the fact that that expenditure is inextricably linked to the activity which gives rise to that income. [37]

54. As regards, however, the German Government's argument concerning the need to take account of the way in which the deductions at issue are classified in national law, I would point out that, while it may have at national level the significance which the legislature and national courts wish to attach to it, no classification under national law of expenditure or of a deduction (whether classified as personal, professional or something other) can be employed to justify discrimination between European citizens on the basis of their place of residence in breach of EU law.

55. It must also be pointed out in that regard that it is clear from settled case-law that, while it is true that, as EU law now stands, direct taxation remains within the competence of the Member States, they must none the less exercise that competence in accordance with the undertakings they have entered into under EU law. [38]

56. The German Government argues in the alternative that, in the present case, there is no direct link between the expenses for which deduction is sought and the taxable income. In its view, the fact that Mr Grünewald would not have been able to acquire the shares in the partnership without agreeing to make the payments is not, in fact, sufficient to substantiate a 'direct link' between the payments and the income generated by a commercial activity. The crucial element in determining the existence of a link of that nature would be the fact that the expenditure cited is incurred specifically as a result of the commercial activity which is taxable in Germany, namely as a result of operating the business, or is inextricably linked to that commercial activity.

57. In the same vein, according to the French Government, the link between the payments and the commercial revenue at issue cannot be classified as direct, since the payments are not specifically linked to the commercial revenue. The French Government cites two recent judgments of the Court in *Commission* v *Finland* [39] and *Commission* v *Germany*, [40] in which, in its view, the Court clarified the meaning and scope of the concept of a 'direct link'.

58. However, it is necessary to note in that regard that there is no reason not to confirm the Court's finding in *Schröder*, to the effect that if the referring court establishes that the obligation to make the private support payment *results from* — that is to say, derives from or has its origin in — the transfer of the assets that generate the income, the expenses relating to the fulfilment of that obligation constitute expenses directly linked to the use of those assets. [41]

59. In the present case, and without prejudice to the determinations which are a matter for the national court, it appears that, just as in *Schröder*, the obligation to make the private support payments results from the transfer of the shares in the partnership from which the taxable income was generated. In fact, the transfer of the shares and the payments form part of one and the same agreement and constitute an exchange. The Bundesfinanzhof itself states in its order for reference that

37 — See *Schröder*, EU:C:2011:198, paragraph 43.

38 — See the judgments in *Schumacker*, EU:C:1995:31, paragraph 21; *Itelcar* C-282/12, EU:C:2013:629, paragraph 26 and the case-law cited; and *Conijn*, C-346/04, EU:C:2006:445, paragraph 14 and the case-law cited.

39 — *Commission* v *Finland*, EU:C:2012:688.

40 — *Commission* v *Germany*, C-600/10, EU:C:2012:737.

41 — See point 45 above and *Schröder*, EU:C:2011:198, paragraphs 45, 46 and 49.

it is apparent from paragraph 2 of the agreement that it is agreed that the payments are made by way of 'consideration' ('Gegenleistung'). This demonstrates that, had Mr Grünewald not accepted the obligation to make the payments to his father, he would not have received the shares in the partnership.

60. Moreover, in the case of the transfer of assets by way of anticipated succession, the existence of a 'direct link' flows from the Bundesfinanzhof's own definition of the arrangement in its case-law. As is clear from point 9 above, according to that court's case-law, the private support payments are payments arising from the element of the assets transferred to which the transferor reserves the right, but which have to be produced by the transferee. Consequently, the payment basically tallies with the income generated by the asset transferred. This shows that there is not merely a direct link, but genuine symmetry as between the expenses in respect of which a deduction is sought (the private support payments) and the taxable income (the profits yielded by the shares in the partnership).

61. As regards the judgments cited by the French Government, in *Commission* v *Finland* the Court was asked to assess the compatibility with Article 63 TFEU of the Finnish system of taxing dividends distributed to the pension funds, which was discriminatory with regard to non-resident pension funds.[42] In my view, that judgment does not support the inference, that the French Government would appear to draw, that the Court had in mind a single criterion — the intention of the legislature — which had replaced the principle, devolving from earlier case-law, of the expenditure and income being inextricably connected, to establish the existence of a direct link. In paragraphs 41 to 43 of that judgment, in fact, the Court did not establish a new criterion but simply rejected the argument of the Finnish Government that the resident and non-resident funds were not comparable on the ground that there was no direct link, finding that it was the legislature itself which, through the national legislation at issue, had established a direct connection between the deductible expenses (the amounts set aside with a view to meeting obligations in respect of pension liabilities) and the taxable income (the dividends) to take account of the specific purpose of the funds,[43] which was a feature shared by both resident and non-resident funds.

62. In *Commission* v *Germany*, however, the Court was asked to assess the compatibility with Article 63 TFEU of the German tax regime under which the non-resident pension funds were unable to deduct from the dividends and interest received in Germany certain expenses which, in the Commission's view, ought to have been regarded as directly linked to them. However, in contrast to the view apparently taken by the French Government, in that judgment, the Court did not modify the approach taken in *Schröder*, on which it actually based its decision,[44] but merely dismissed the Commission's application on the ground that it had failed to discharge the burden of proof. More specifically, the Court criticised the Commission for failing to furnish sufficient proof that the expenses (bank and transaction costs, as well as the costs of human resources) were specifically needed in order to obtain that income. In other words, to use the terminology employed in *Schröder*, the Commission failed adequately to prove that those expenses resulted from, or originated in, the activity generating the taxable income.

63. The German Government also argues that, if Mr Grünewald's State of residence had also to take into account the private support payments that he made for the purposes of deduction linked to his personal circumstances, there would be a risk of them being deducted twice over, with the result that non-residents would enjoy more favourable treatment than that accorded to residents. The possibility of a risk of that nature, which appears somewhat theoretical in the present case, is not capable of

42 — While the resident funds were able to deduct for tax purposes the amounts set aside with a view to meeting obligations in respect of pension liabilities, which resulted in the de facto exemption from tax of the dividends received, that option was not available to the non-resident funds. See *Commission* v *Finland*, EU:C:2012:688, paragraph 2.

43 — Namely to accumulate capital, by way of investments producing, in particular, an income in the form of dividends in order to meet their future obligations under insurance contracts, *Commission* v *Finland*, EU:C:2012:688, paragraph 42.

44 — *Commission* v *Germany*, EU:C:2012:737, paragraph 17.

justifying the discriminatory treatment of non-resident taxpayers. Indeed, both Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums,[45] in force at the material time, and Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799[46] provide for an exchange of information between the relevant tax authorities, so that the German finance ministry is able to inform the State of residence of a taxpayer with limited tax liability of the request to deduct submitted by the latter, in order to prevent any double counting of costs.[47]

64. Lastly, the French Government claims in the alternative that, should the Court find national legislation which prevents a non-resident taxpayer from deducting the private support payments he has made to be incompatible with Article 63 TFEU, the deduction should not be set against the aggregate income generated by that person in the State in which he does not reside, but should be permitted solely in relation to the specific income generated by the activity directly linked to the payments, and thus, in the present case, solely the income generated in Germany by Mr Grünewald through his share in the partnership.

65. In that regard, however, I agree with the view expressed by the Commission at the hearing that, provided that the method adopted does not involve discrimination between resident and non-resident taxpayers, it is for the national tax authorities to determine the specific methods of calculating deductions or the taxable amount against which the deductions may be made.

2. Whether there is an overriding reason in the public interest.

66. It is established case-law that a restriction of free movement of capital is permissible only if it is justified by overriding reasons in the public interest.[48] Whereas in the case of *Schröder*, no overriding reason in the public interest was invoked by the German Government or contemplated by the referring court,[49] two such reasons are advanced in the present case.

a) The balanced allocation between Member States of powers of taxation

67. The referring court first questions whether refusing the non-resident taxpayer the possibility of deducting the payments which he has to make may be justified in order to safeguard the balanced allocation of taxation powers between the Member States, in accordance with the principle of territoriality. Citing the abovementioned 'Korrespondezprinzip'[50] which, in its view, implies that the assessment under EU law of the legislation at issue cannot be made without taking into account the tax position of the recipient of the payments, the referring court asks whether the State of origin of the income may not be entitled to safeguard its right to levy tax by prohibiting deduction in the case of a non-resident taxpayer if, for factual reasons, it is not possible to impose taxes on the recipient, where, for instance, that person is not resident in Germany.

45 — OJ 1977 L 336, p. 15.

46 — OJ 2011 L 64, p. 1.

47 — See also to that effect the judgments in *Centro Equestre da Lezíria Grande*, EU:C:2007:96, paragraph 36, and *van Caster*, C-326/12, EU:C:2014:2269, paragraph 55.

48 — See, among many, *DMC*, C-164/12, EU:C:2014:20, paragraph 44 and the case-law cited.

49 — *Schröder*, EU:C:2011:198, paragraph 48.

50 — See point 12 above.

68. It should be recalled here, first, that safeguarding the balanced allocation of taxation powers between Member States is a legitimate objective recognised by the Court and, secondly, that it is settled case-law that, in the absence of any unifying or harmonising measures of the European Union, the Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation. [51]

69. In the present case, however, it must first be pointed out that it is apparent from neither the order for reference nor any other of the documents before the Court that the payments made by Mr Grünewald to his father cannot be subject to taxation in Germany. Indeed, there is nothing to suggest that his father is resident outside Germany or that there is any other reason why he cannot be liable for tax on the payments. This therefore appears to be a hypothetical argument which, subject naturally to verification by the referring court, cannot in any event justify the discrimination suffered by Mr Grünewald in the present case.

70. Secondly, and in any case, as set out in point 48 above, regardless of the 'Korrespondenzprinzip', [52] the tax treatment of the recipient of the payments cannot justify discrimination against the non-resident taxpayer. The legislation at issue, and specifically Paragraph 50 of the EStG, generally precludes any deduction by way of 'special expenditure' in cases in which the debtor has limited tax liability. Consequently, the deduction of private support payments is in any event precluded in the case of a non-resident taxpayer, regardless of both the creditor's place of residence and the fact that the recipient is liable for tax on the payments. That legislation is in no way designed to safeguard the balanced allocation of powers to impose taxes and cannot in any case be regarded as a measure proportionate to that objective.

b) The coherence of the national tax system

71. Relying specifically on the same arguments which the Bundesfinanzhof employed to express its doubts regarding the ground of appeal relating to the balanced allocation of taxation powers between Member States, the German Government puts forward as justification for the tax treatment at issue the need to guarantee the coherence of the national tax system. According to that government, because of the 'Korrespondenzprinzip' and the consequent transfer of the ability to pay tax between the debtor and the creditor of the payments, [53] the group of generations involved in the succession ('Generationennachfolgeverbund') within which the process of anticipated succession takes place (made up, in the present case, of the parents and two sons) should be regarded as a single tax entity and, consequently, taxed on a uniform basis. [54] According to the German Government, if the deduction of the private support payments were permitted in Germany but those payments were not, at the same time, subject to taxation with the recipient being liable for the tax, the single tax entity would benefit from a twofold advantage and that would undermine the coherence of the German tax system.

51 — *DMC*, EU:C:2014:20, paragraphs 46 and 47 and the case-law cited.

52 — In its order for reference, the Bundesfinanzhof cites the judgment in *Schempp* (C-403/03, EU:C:2005:446). That reference appears to me to be irrelevant since that case concerned the non-deductibility in a Member State of maintenance paid in another Member State and, therefore, the relationship between two different tax systems (see paragraph 35 in particular), whereas the issue of the deductibility of the private support payments and the *corresponding* taxation of the recipient is exclusively a matter for the German tax system.

53 — See points 10 and 12 above.

54 — The German Government contends that, in similar cases, such as that of groups of companies, the Court has recognised different persons as forming a single tax entity. It cites, in particular, *Papillon*, C-418/07, EU:C:2008:659.

72. It must be recalled in that regard that, according to settled case-law, the Court recognises the need to guarantee the coherence of national tax systems as an overriding reason in the public interest.[55] However, for an argument based on such a justification to succeed, a direct link must be established, according to that case-law, between the tax advantage concerned and the compensating of that advantage by a particular tax levy, with the direct nature of that link falling to be examined in the light of the objective pursued by the rules in question.[56] Moreover, there is no such direct link when it is a question, in particular, of different taxes or the tax treatment of different taxpayers.[57]

73. In the present case, however, it is clear that the tax treatment in question concerns different taxpayers: on the one hand, the debtor of the private support payments who, if resident in Germany, can deduct those payments, and, on the other, the recipient who, under the 'Korrespondenzprinzip', is liable for tax on the payments.

74. The German Government takes the view, however, that the direct link required by case-law between tax advantage and tax levy can exist even if different taxpayers are involved because, on the basis of the 'Korrespondenzprinzip', the 'Generationennachfolgeverbund' should be treated as a single tax entity.

75. I am not at all persuaded by that argument.

76. Indeed, it seems to me, first, clearly to contradict what the German Government itself has maintained — and which I have discussed in point 56 et seq. above — namely, the assertion that there is no direct link between the expenses for which deduction is sought (that is the private support payments for which the recipient has tax liability) and the taxable payments. Indeed, if it is argued that there is no direct link between the deductible expenses and the taxable payments, I wonder how it can be argued that such a link does exist between the tax advantage and the levy.

77. Secondly, it contradicts the practice of the German tax authorities which, under the tax legislation at issue, do not always treat the 'Generationennachfolgeverbund' as a single tax entity, but do so only if the debtor taxpayer is resident in Germany. In fact, it is only in that event that there is correspondence between the taxation and deduction of the payments. Pursuant to Paragraph 50 of the EStG, however, non-resident taxpayers are always refused deduction of the private support payments, whether or not the payments are taxed in Germany.

78. Furthermore, at the hearing, the German Government itself acknowledged that if the recipient of the payments resides abroad — which, as we have seen, is somewhat hypothetical in the present case — the resident debtor taxpayer is allowed to deduct the private support payments even if they are not taxed in Germany, provided that he produces a certificate from the Member State in which the recipient of the payments resides confirming that the payments are subject to taxation in the latter Member State.

79. In my view, it is clear from those considerations that the 'Korrespondenzprinzip' is not the lynchpin of any form of coherence that, as the German Government maintains, needs to be safeguarded within the national tax system and could justify discriminatory treatment of a non-resident taxpayer.

80. It follows that, in my view, none of the overriding reasons in the public interest which have been set out can justify the restriction on the free movement of capital which has been established.

55 — See, among many, the judgments in *Manninen*, C-319/02, EU:C:2004:484, paragraph 42 and *Papillon*, EU:C:2008:659, paragraph 43.

56 — See, among many, *Emerging Markets Series of DFA Investment Trust Company*, C-190/12, EU:C:2014:249, paragraph 92 and the case-law cited.

57 — See *DI. VI. Finanziaria di Diego della Valle & C.*, C-380/11, EU:C:2012:552, paragraph 47 and the case-law cited. I would also refer, in that connection, to point 35 et seq. of my Opinion in *Commission* v *Portugal* (C-493/09, EU:C:2011:344).

V – **Conclusion**

81. For the reasons set out above I therefore propose that the Court give the following answer to the question referred by the Bundesgerichtshof:

Article 63 TFEU must be interpreted as precluding legislation of a Member State, such as that at issue in the main proceedings, which permits resident taxpayers, but not non-resident taxpayers, to deduct private support payments made in the context of a transfer of revenue-producing domestic assets by way of anticipated succession, where the undertaking to make those support payments derives from the transfer of those assets, even if that legislation provides for an equivalent corresponding tax liability for a recipient of the payments with full tax liability in that State.