OPINION OF ADVOCATE GENERAL MENGOZZI

delivered on 29 March 2007 [1]

I — Introduction

1. Over the last few years the Court has heard a significant number of cases in which it has been asked to adjudicate on the relationship between various aspects of direct taxation of the Member States and the freedoms of movement provided for by the EC Treaty.

2. As Advocate General Geelhoed observed recently in connection with the application of these freedoms in the field of corporate taxation, [2] the increasingly complicated factual and legislative contexts facing the Court seek to test the limits of the freedoms of movement provided for in the Treaty.

3. The reference for a preliminary ruling from the Finanzgericht (Finance Court) Münster (Germany) presently before the Court is one such case.

4. The Court is called on here essentially to rule on whether freedom of establishment and the free movement of capital preclude a Member State, in this case the Federal Republic of Germany, for the purpose of avoiding double taxation of the income and capital of persons with full liability to tax in its territory derived from particular investments in another Member State, from unilaterally replacing the 'exemption' method by the 'set-off' method, notwithstanding the provisions of the double taxation convention concluded earlier between those two States.

5. The two methods referred to above are generally used by States, unilaterally or bilaterally, in order to avoid or reduce juridical double taxation (taxation of the same income twice in the hands of the same taxpayer) or economic double taxation (taxation of the same income twice in the hands of two different taxpayers), in particular in cross-border situations.

1 — Original language: French.

2 — See Opinion in Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, point 3.

6. The exemption method allows a resident of one State, who receives income or capital taxed in the State from which that income is derived or in which that capital is situated, to enjoy tax exemption in his State of residence on that income or capital. The State of residence may however apply that method subject to progressivity, which consists in taking the exemption into account when calculating the amount of tax on the remainder of the resident's income or capital.

7. Under the set-off method, the State of residence makes a tax deduction or a tax credit in respect of the tax it levies on the resident's income or capital equal to the amount of tax paid on the income or capital in the source State.

8. One of the special characteristics of this case lies in the fact that replacement of the exemption method by the set-off method provided for by the German tax law is conditional on the Member State in which the investment is made applying a lower rate of taxation than the rate of taxation provided for in the German tax legislation in force at the relevant time in the main proceedings. As we shall see in greater detail below, those provisions, applying to 'permanent places of business' established by German residents abroad, are contained in the German legislation on controlled foreign corporations ('CFCs').

9. As the legal analysis below will show, I consider that this case calls for the interpretation and application of two trends in the case-law of the Court, one relating to the avoidance of double taxation, the other more recent trend relating to the compatibility of the laws of the Member States designed to cancel out any tax advantages obtained by Community nationals in other Member States which apply a lower rate of taxation than that in force in the Member State in which those nationals are resident. Although not necessarily conflicting, those two trends in the case-law must be looked at together in order to strike a fair balance between, on the one hand, the powers of taxation of the Member States and, on the other hand, respect for the operation of the internal market, in particular for the exercise of the freedoms of movement ensured by the Treaty.

II — Legal background

A — *German tax law and the avoidance of double taxation in Germany*

10. Under Paragraph 1 of the Einkommensteuergesetz (Income Tax Law) ('the EStG'), [3]

3 — RGBl. 1934 I, p. 1005.

taxpayers established in Germany are in principle taxed on their total income, irrespective of whether it derives from Germany or from abroad. This rule applies to all types of income, including trading results and income on capital.

11. Under the German tax system, profit made by partnerships, whether German or foreign, is not allocated directly to such partnerships but to the individual partners, natural persons, who have unlimited tax liability in Germany, in proportion to their shareholding, and is taxed as theirs (the principle known as 'tax transparency of partnerships'). In the case of foreign partnerships, like the claimant in the main proceedings, Columbus Container Services BVBA & Co ('Columbus'), this direct allocation of the profit to partners residing in Germany applies even if the partnership is subject, as such, to corporation tax in the Member State in which it is registered.

12. With a view to avoiding double taxation of income and capital which German residents acquire abroad, the Federal Republic of Germany has concluded bilateral conventions, based on the Model Convention on Income and Capital of the Organisation for Economic Cooperation and Development (OECD), including the convention that is relevant in the present case, with the Kingdom of Belgium.

13. Under Article 23 of the Convention signed in Brussels on 11 April 1967 between the Kingdom of Belgium and the Federal Republic of Germany for the avoidance of double taxation with respect to taxes on income, [4] income of German residents derived from Belgium, including income from capital invested in general partnerships and limited partnerships located in Belgium, which is taxable in that State by virtue of the provisions of that convention, is exempt from tax in Germany. That exemption also applies to capital of German residents which is located in Belgium. The Federal Republic of Germany retains the right, however, to take into account, when determining its rate of taxation, all income and capital so exempted (exemption method applied, where appropriate, subject to progressivity).

14. Paragraph 20(2) and (3) of the Gesetz über die Besteuerung bei Auslandsbeziehungen (Außensteuergesetz) (Foreign Transaction Tax Law), [5] as amended by the Missbrauchsbekämpfungs- und Steuerbereinigungsgesetz (Law on combating abuse and

4 — BGBl. 1969 II, p. 18, and *Moniteur belge* of 30 July 1969, respectively.

5 — BGBl. 1972 I, p. 1713.

harmonising taxation)[6] of 21 December 1993 (the 'AStG'), and as applying at the relevant time in the main proceedings, derogates however from this rule in certain cases. That provision was inserted into the AStG in order, in particular, to prevent German residents from circumventing the other provisions of the AStG concerning the taxation of income arising from CFCs ('Zwischengesellschaft'), with their own legal personality, established in Member States with a low rate of taxation. Those provisions are designed to prevent tax avoidance.

15. With regard to the avoidance of double taxation of income arising from a permanent establishment, Paragraph 20(2) of the AStG states that '[w]here designated passive income within the meaning of the second sentence of Paragraph 10(6) arises from the foreign establishment of a party with unlimited liability to tax in Germany and where that income would be liable to tax as controlled-foreign-corporation income if that permanent establishment were a foreign corporation, double taxation shall be avoided in this respect by offsetting the foreign taxes levied on that income rather than by way of exemption'.

16. As regards avoidance of double taxation of capital, Paragraph 20(3) of the AStG provides that '[w]here assets are derived from designated passive income within the meaning of the second sentence of Paragraph 10(6), apart from designated passive income within the meaning of the third sentence of Paragraph 10(6), in the cases referred to in paragraph (2), double taxation shall be avoided by offsetting the foreign taxes levied on those assets rather than by way of exemption.'

17. The second sentence of Paragraph 10(6) of the AStG provides that 'designated passive controlled-foreign-corporation income shall mean income from a controlled foreign corporation which is derived from holding, administering or maintaining or increasing the value of payment media, receivables, securities, investments and similar assets ...'.

18. The documents on the file show that the AStG requires four further conditions to be met in order for the set-off method provided for in Paragraph 20(2) and (3) of the AStG to apply. Those conditions are as follows:

— designated passive income arising from the foreign place of business is liable to 'low taxation', within the meaning of Paragraph 8(3) of the AStG, that is to say, the income is subject in the State in

6 — BGBl. 1993 I, p. 2310.

which the business is managed to corporation tax of less than 30%;

— designated passive income does not meet the conditions laid down in Paragraph 8(1), point 7, Paragraph 8(2) or Paragraph 13 of the AStG;

— designated passive income cannot be regarded as deriving from an 'active' activity listed in Paragraph 8(1), points 1 to 6 of the AStG;

— a holding by German taxpayers of at least 10% is required in the permanent establishment.

III — The main proceedings and the question referred for a preliminary ruling

19. Columbus is a limited partnership governed by Belgian law. It was formed in 1989 and has its registered office in Antwerp (Belgium). In 1996 its shares were held by eight natural persons residing in Germany, at least six of whom belonged to the same family, each of them having a 10% holding. Also involved, with a 20% holding, was a partnership governed by German law whose members were also established in Germany.

20. Columbus is not liable to tax in Germany. For the purposes of German tax legislation, it is not regarded as a CFC but is treated as a foreign 'permanent establishment' of the partners established in Germany. The income and assets of Columbus are therefore directly allocated to its partners for the purposes of levying tax on income and capital in Germany.

21. Columbus's objectives are to coordinate the activities of the Oetker group, by providing intra-group financial services. The objectives include the centralisation of financial transactions, the financing of the liquidity of subsidiaries and branches, the centralisation and coordination of the accounts, of administrative matters and of advertising and marketing activities and the computerisation of data.

22. Columbus's economic activity is mainly the management of designated passive income, within the meaning of the second sentence of Paragraph 10(6) of the AStG. Through such management Columbus was able to achieve in the course of 1996 'trading

results' of DEM 8 044 619 and 'other income' of DEM 53 477.

23. The Belgian tax authority treated Columbus as a 'coordination centre' within the meaning of Royal Decree no 187 of 30 December 1982 on the creation of coordination centres.[7] The tax regime for coordination centres derogates from the ordinary Belgian tax regime in several respects. First, a centre's taxable income is determined at a standard rate according to the cost-plus method. That income represents a percentage of the total operating expenses and costs, from which staff costs, financial charges and corporation tax are excluded.[8] Under that regime, Columbus was taxed in 1996 on less than 30% of the profit actually made.

24. In Germany, the Finanzamt Bielefeld-Innenstadt (Bielefeld-Innenstadt Tax Office) treated the claimant as a partnership. Referring to Paragraph 20(2) of the AStG, the German tax authority, in a tax notice of 8 June 1998 determining profits for 1996, allocated Columbus's 'trading results' of DEM 8 044 619 and 'other income' of DEM 53 477 to its partners. The Finanzamt Bielefeld-Innenstadt categorised the latter income as tax-exempt, but made it subject to progressivity. On the other hand, it taxed the profit of DEM 8 044 619 in full, although it did offset the amount of tax paid on it in Belgium.

25. In a notice of 16 June 1998, the German tax authority determined the reference value of Columbus's business assets for the purposes of calculating the partners' tax on capital as at 1 January 1996.

26. Columbus, acting on behalf of the partners, appealed against those notices, apart from that relating to 'other income', before the Finanzgericht Münster (Münster Finance Court) (Germany), claiming in particular that Paragraph 20(2) and (3) of the AStG was incompatible with the provisions of Article 52 of the EC Treaty (now, after amendment, Article 43 EC). According to Columbus, replacement of the exemption method, provided for in Article 23 of the double taxation convention between the Federal Republic of Germany and the Kingdom of Belgium with the set-off method provided for in Paragraph 20(2) and (3) of the AStG has had the effect of increasing the tax burden of each of the partners by around EUR 250 000 for the year in question.

27. The Finanzgericht Münster does not exclude the possibility that the rules contained in Paragraph 20(2) and (3) of the

7 — *Moniteur belge* of 13 January 1983.

8 — See, in that regard, Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187* v *Commission* [2006] ECR I-5479, paragraph 9.

AStG infringe the right of freedom of establishment. It also has doubts as to whether those rules are compatible with the free movement of capital, in so far as the additional taxation to which it subjects foreign income is likely to dissuade a resident from investing in another Member State.

28. In those circumstances, the Finanzgericht Münster decided to stay the proceedings and to refer the following question to the Court for a preliminary ruling:

'Is it contrary to the provisions of Article 52 of the EC Treaty (now Article 43 EC) and Article 73b to 73d of the EC Treaty (now Articles 56 EC to 58 EC) for the rules in Paragraph 20(2) and (3) of the German Foreign Transaction Tax Law (Gesetz über die Besteuerung bei Auslandsbeziehungen (Außensteuergesetz)), as amended by the Law combating abuse and streamlining taxation (Missbrauchsbekämpfungs- und Steuerbereinigungsgesetz) of 21 December 1993 to exempt from double taxation the designated passive income of a foreign permanent establishment of a party with unlimited liability to tax in Germany, which would be liable to tax as controlled-foreign-corporation income if the permanent establishment were a foreign corporation, by offsetting the foreign tax on earnings levied on the income rather than by exempting the income from taxation in Germany contrary to the double taxation convention between the Federal Republic of Germany and the Kingdom of Belgium of 11 April 1967?'

IV — Procedure before the Court

29. Columbus, the German, Belgian, Netherlands, Portuguese and United Kingdom Governments and the Commission of the European Communities submitted written observations to the Court under Article 23 of the Statute of the Court of Justice. Those parties also presented oral argument at the hearing which took place on 28 September 2006, with the exception of the Portuguese Republic, which was not represented at the hearing.

V — Analysis

A — *An outline of the issue raised in the question referred for a preliminary ruling*

30. Before considering the question referred for a preliminary ruling from the viewpoint of Community law, it is necessary to provide a clear outline of the issue raised by the referring court.

31. Three questions should, in my view, be eliminated from the assessment the Court is called upon to make in this case.

32. First of all, it should be pointed out that the question referred for a preliminary ruling relates not directly to the system applying to 'holdings of controlled foreign corporations',[9] provided for in Chapter 4 of the AStG (Paragraphs 7 to 14 of that Law), but to the system relating to application of 'conventions for the avoidance of double taxation', provided for in Paragraph 20(2) and (3) of the AStG, in the case of certain profits made by foreign permanent establishments which do not have their own legal personality under German tax law and whose partners are taxed on the totality of their income and capital in Germany.

33. Chapter 4 of the AStG governs the tax treatment of entities established abroad which have their own legal personality under German tax law[10] and in respect of which it is provided that the profits they make, within the meaning of the AStG, in a particular financial year in a State where the level of taxation is lower than that referred to in the AStG (less than 30%), are deemed to have been distributed to their shareholders, who are persons with unlimited tax liability in Germany, in that financial year.[11]

34. It should of course be noted that, in order to determine whether, as in the dispute in the main proceedings, a foreign permanent establishment within the meaning of Paragraph 20(2) and (3) of the AStG falls within the scope of the AStG, reference made in that paragraph to the conditions that also apply to controlled foreign corporations.

35. Moreover, as the German Government admits, Paragraph 20(2) and (3) of the AStG pursues an objective similar to that of the provisions governing controlled foreign corporations in that it is designed to prevent German taxpayers from circumventing the rules laid down in Chapter 4 of the AStG governing controlled foreign corporations by setting up permanent establishments abroad, as in the dispute in the main proceedings, and benefiting, on the profits those permanent establishments make in Member States with a lower rate of taxation than that provided for in Germany, from tax exemption in that State pursuant to double taxation conventions concluded by the Federal Republic of Germany.

36. Although those circumstances cannot be entirely disregarded, inter alia in order to understand the background to Paragraph 20(2) and (3) of the AStG, the fact remains that the Court is not being asked to interpret Community law in the context of the application of the provisions of Chapter 4 of the AStG in relation to a controlled foreign corporation, the applicable regime for which appears to be different from that provided for in Paragraph 20(2) and (3) of the AStG.

9 — That is to say, CFCs.

10 — See Paragraph 7(1) of the AStG.

11 — See Paragraph 10(1) and (2) of the AStG.

37. Indeed, the referring court has clearly established that under German tax law, Columbus, being a partnership, falls within Paragraph 20(2) and (3) of the AStG, irrespective of where it is established, and not within the system applying to CFCs pursuant to the other provisions of the AStG.

38. Next, and this question is linked to the first, it should be made clear that it is not the difference between the Federal Republic of Germany and the Kingdom of Belgium in respect of the legal and fiscal classification of Columbus which the referring court regards as involving a possible restriction on the freedoms of movement under the Treaty, but merely the replacement of the exemption method by the set-off method as regards taxation of the income and capital of a permanent establishment located abroad.

39. As stated above, in Belgium Columbus has been set up as a limited partnership. Belgian law grants it independent legal personality from that of its partners, that is, general partners and limited partners. As regards taxation, Columbus is in principle liable to pay corporation tax, but also enjoys the regime applying to coordination centres. It nevertheless has legal personality. In Germany, however, Columbus is considered to be a partnership which, as regards taxation, is equated with a permanent establishment of partners, who are natural persons residing in Germany, so that the profits made by Columbus are directly allocated to those partners. Columbus therefore has fiscal transparency in that State, as regards taxation.

40. International tax studies on the problem of the transparency of partnerships have highlighted the incredible complexity of this branch of law, [12] due in particular to the classification of a partnership, which is described as a partnership in one State but as a business corporation in another, and to the bilateral or triangular nature of the relationships to be considered (the State of the source of the income, the State of the partnership, the State of residence of the partner). These difficulties may however be eased by the provisions of taxation conventions between States.

41. At the current stage of development of Community law, it does not require Member States to recognise in their territory the legal and tax status afforded by the domestic law

12 — The expression used by General Rapporteur J.-P. Le Gall in a study on comparative fiscal law assembling over 28 national reports, prepared by the International Fiscal Association, entitled 'International Tax Problems of Partnerships', in *Cahiers de Droit Fiscal International*, Kluwer Law International, The Hague, 1995, p. 604.

of the other Member States to entities which carry out their economic activities there.

42. In that regard, the third indent of Article 220 of the EC Treaty (now the third indent of Article 293 EC) provides that Member States are, so far as is necessary, to enter into negotiations with each other with a view to securing, for the benefit of their nationals, the mutual recognition of companies or firms within the meaning of the second paragraph of Article 58 of the EC Treaty (now the second paragraph of Article 48 EC).

43. On the basis of that provision, on 29 February 1968 the six founding members of the European Economic Community signed in Brussels the Convention on the mutual recognition of companies and bodies corporate. [13] As not all of those States ratified the convention, it did not enter into force.

44. Although there is no mutual recognition of companies and legal persons, Member States must respect the freedoms of movement provided for in the Treaty.

45. In the present case, the possible restriction on the freedoms of movement is not to be found in the classification of Columbus as a permanent establishment under German tax law, since it is precisely because of that classification that Columbus was able, until the tax year in question, to enjoy the exemption method under the relevant provisions of the double taxation convention between the Federal Republic of Germany and the Kingdom of Belgium, which Columbus is seeking to retain in the main proceedings. [14]

46. Lastly, I do not think it is necessary for the Court to consider Columbus's contentions that Paragraph 20(2) and (3) of the AStG conflict with the provisions of that double taxation convention. It should be noted that the Court of Justice has no jurisdiction under Article 177 of the EC Treaty (now Article 234 EC) to rule on that question, which does not concern the interpretation of Community law. [15]

47. Naturally, this assessment does not mean that the Court, in order to provide an

13 — *Bulletin of the European Communities*, Supplement 2/69, p. 7.

14 — If Columbus had been classified as a business corporation under German law, it is most likely that the apparently less favourable system for controlled foreign companies (CFCs) would have applied to it (Chapter 4 of the AStG). That scenario is not dealt with in the present analysis, however, since the referring court has not raised the issue.

15 — See, to that effect, Case C-141/99 *AMID* [2000] ECR I-11619, paragraph 18. See also point 25 of the Opinion of Advocate General Ruiz-Jarabo Colomer in Case C-336/96 *Gilly* [1998] ECR I-2793.

interpretation of Community law which will be of use to the national court, cannot take into account, where appropriate, the provisions of a double taxation convention where, as in the present case, the referring court rightly presents it as falling within the legal framework applicable to the case in the main proceedings.[16] It is my view, as it was Advocate General Geelhoed's in his Opinion in *Denkavit Internationaal and Denkavit France*,[17] that the actual effect of a double taxation convention on a taxpayer's situation should be taken into account in assessing whether, in a specific case, there is a restriction on the freedoms of movement guaranteed by the Treaty. Otherwise, the economic reality of that taxpayer's activity and any incentives linked to the cross-border context, in particular, would not be taken into account.

48. This said, it should be made clear first of all, with regard to the legal and factual background provided by the referring court, which of the two freedoms of movement mentioned by the national court (freedom of establishment and free movement of capital) mainly applies in the present case. My analysis will then turn to an assessment of the restrictive effect of replacing the exemption method by the set-off method for purposes of avoiding double taxation, in Germany, of income and capital received by the partners in Columbus. Lastly, if such a restriction were accepted, it would be appropriate to question whether it would be justified on grounds of overriding public interest.

B — *The question whether the provisions relating to freedom of establishment or to the free movement of capital are applicable*

49. The referring court asks whether a rule like that laid down in Paragraph 20(2) and (3) of the AStG is compatible with freedom of establishment or the free movement of capital.

50. According to the case-law, where a national of a Member State has a holding in the capital of a company established in another Member State which gives him definite influence over the company's decisions and allows him to determine its activities, it is the Treaty provisions concerning freedom of establishment which apply and not those concerning the free movement of capital.[18]

16 — See, to that effect, Case C-170/05 *Denkavit Internationaal and Denkavit France* [2006] ECR I-11949, paragraph 44, and case-law cited.

17 — See points 33 to 38 of the Opinion in *Denkavit Internationaal and Denkavit France*, cited above.

18 — See, inter alia, Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22; Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 37; and Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 31.

51. The boundary between these two freedoms is not always clear, particularly in the case of a reference for a preliminary ruling, where the national court is better placed to assess in the particular circumstances the rights conferred on a Community national as a result of the shareholdings he has in the company concerned.

52. In the present case, as stated in point 18 above, it appears that one of the facts giving rise to application of Paragraph 20(2) and (3) of the AStG is the shareholding by a German taxpayer of at least 10% in the permanent establishment. In principle, it would seem that a holding of this size would preclude the possibility of exercising definite influence over the company's decisions and determining its activities. If that is the case, the compatibility of the contested provisions should first of all be assessed in the light of Articles 73b to 73d of the EC Treaty.

53. The applicability of freedom of establishment might however be relevant in the light of the circumstances described below.

54. On one hand, the objective pursued by the German legislature in replacing the exemption method by the set-off method is to avoid circumvention of the provisions of German tax legislation, including those of the AStG concerning CFCs set up abroad in the form of subsidiaries. In this regard, the various aspects of the AStG relate mainly to the establishment of German residents abroad, in the present case in the form of a partnership, which is regarded under German tax legislation as being a permanent establishment.

55. On the other hand, in the dispute in the main proceedings, not only is Columbus controlled by at least six natural persons belonging to the same family, each of them having a 10% shareholding in the establishment concerned, but, in particular, those persons, as Columbus stated at the hearing, act together and are represented by a single person at the general meeting of the partners. Those eight partners therefore appear to be in a position to exercise, collectively, definite influence over Columbus's decisions. In that context, the possible infringement of the right of free movement of capital is merely a consequence of the alleged restriction on freedom of establishment.

56. In the light of all the above considerations and in the absence of sufficiently clear evidence from the national court to determine with certainty which of the two freedoms mentioned above is actually mainly affected in the present case, legislation such as that at issue in the main proceedings should definitely be considered in the light of both Article 52 and Article 73b of the EC Treaty.

57. However, it seems to me that in the present case application of either of those provisions should lead to the same result. I therefore propose to analyse this case in the light of Article 52 of the EC Treaty, bearing in mind the fact that comparable reasoning would also apply as regards Article 73b of the EC Treaty.

C — *The existence of a restriction on freedom of establishment*

58. The main difficulty in this case concerns whether or not a rule such as that contained in Paragraph 20(2) and (3) of the AStG can be classified as a restriction on freedom of establishment.

59. Columbus and the Belgian Government consider that Paragraph 20(2) and (3) of the AStG deters German nationals from establishing themselves in the Member State of their choice, since the set-off method applies only if the income received by German residents is 'passive' income coming from a Member State where the level of taxation is lower than that provided for in the AStG.

60. However, the other parties which have submitted observations to the Court, that is to say, the German, Netherlands, Portuguese and United Kingdom Governments and the Commission, contend that the rule laid down in Paragraph 20(2) and (3) of the AStG restores equal treatment between a cross-border tax situation, like that of the partners in Columbus, and a purely domestic situation. Thus, those parties do not consider there is a restriction on freedom of establishment.

61. It is appropriate to note that freedom of establishment, granted to Community nationals by Article 52 of the EC Treaty, includes the right for them 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 country where such establishment is effected, [19] or nationals of other Member States residing on its territory. [20]

62. Even though, according to their wording, the Treaty provisions concerning freedom of establishment are aimed at ensuring that foreign nationals and companies are treated in a host Member State in the same way as nationals of that State, the Court has held

19 — See, inter alia, Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 40, and *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, paragraph 41.

20 — See *Baars*, cited above, paragraph 29.

that they also prohibit the *Member State of origin* from hindering the establishment in another Member State of one of its nationals. [21]

63. Moreover, the prohibition on Member States introducing restrictions on freedom of establishment also applies to tax provisions. According to case-law, although in the current state of Community law direct taxation does not as such fall within the scope of the European Community's jurisdiction, Member States must nevertheless exercise their retained powers in compliance with Community law. [22]

64. Thus, as regards restrictions deriving from the tax law of the Member State of origin, the Court has held that the Treaty provisions concerning freedom of establishment preclude a Member State from establishing, in order to prevent a risk of tax avoidance, a mechanism for taxing income from as yet unrealised increases in the value of securities, where a taxpayer transfers his tax residence outside that State, although increases in the value of those of a taxpayer who remained in that State would become taxable only when they were actually realised. According to the Court, even though the national rules at issue in that case did not prevent taxpayers from exercising their right of establishment, it was nevertheless 'of such a kind as to restrict the exercise of that right, having at the very least a *dissuasive* effect on taxpayers wishing to establish themselves in another Member State'. [23] The Court therefore held that the difference in treatment as regards the taxation of increases in value was 'likely to *discourage* a taxpayer' from transferring his tax residence outside the Member State in question and hence was liable to restrict freedom of establishment. [24]

65. More recently, in *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, the Court held in a reference for a preliminary ruling regarding the United Kingdom legislation on CFCs that the separate tax treatment under that legislation and the resulting disadvantage for resident companies which have a subsidiary subject, in another Member State, to a lower level of taxation are such as to hinder the exercise of freedom of establishment by such companies, *dissuading them from establishing, acquiring or maintaining a subsidiary* in a Member State in which the latter is subject to such a level of taxation and therefore constituting a restriction on freedom of establishment. [25]

21 — See, inter alia, Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483, paragraph 16; Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 21; *De Lasteyrie du Saillant*, cited above, paragraph 42; and Case C-446/03 *Marks & Spencer* [2005] ECR I-1083, paragraph 31 (emphasis added).

22 — See, to that effect, *De Lasteyrie du Saillant*, cited above, paragraph 44; *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, paragraph 40; and *Denkavit Internationaal and Denkavit France*, cited above, paragraph 18. See also, recently, with regard to the free movement of capital, Case C-513/04 *Kerckhaert and Morres* [2006] ECR I-10967, paragraph 15 and case-law cited therein.

23 — *De Lasteyrie du Saillant*, cited above, paragraph 45 (emphasis added).

24 — Ibid., paragraphs 46 to 48 (emphasis added). See also Case C-470/04 *N* [2006] ECR I-7409, paragraphs 34 to 39.

25 — Paragraph 46 (emphasis added).

66. That judgment, which will be considered at greater length below, is of particular interest in the present case. It was also the subject of fairly significant discussion between the parties at the hearing.

67. At this stage of my considerations, suffice it to say that in *Cadbury Schweppes and Cadbury Schweppes Overseas* the Court held that, on the one hand, the parent company established in the United Kingdom of a subsidiary established in a Member State where profits were subject to a lower level of taxation than that applying in the United Kingdom and that State's legislation on CFCs applied to those profits, and, on the other hand, the parent company established in the United Kingdom whose subsidiary was also incorporated in that State *or* the parent company established in the United Kingdom whose subsidiary was established in a Member State where profits were subject to a higher level of taxation than that applying in the United Kingdom and the United Kingdom legislation on CFCs did not apply to those profits in either of those situations, were in a comparable situation.

68. As *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, illustrates, determination of the (objective) comparability of situations is of fundamental importance in assessing whether application of a national measure fails to uphold the equal treatment that must in principle be ensured between those situations and, hence, whether that measure is liable to restrict freedom of establishment.

69. Here it is a matter of whether it is possible in this case to transpose a similar reasoning to that followed by the Court in *Cadbury Schweppes and Cadbury Schweppes Overseas* with regard to the comparability of the situations of subsidiaries of parent companies established in the United Kingdom to which the legislation on CFCs did or did not apply.

70. If such an assessment is to be made, as I propose to do, it should also take into consideration the case-law of the Court relating to the avoidance of double taxation, which has been the subject of significant clarifications recently, in particular in *Test Claimants in the FII Group Litigation.* [26]

71. It is therefore necessary in my view to consider the tax treatment of the income and capital of the partners in Columbus as compared, on the one hand, with that of the partners in a partnership who have not exercised their right of freedom of movement (domestic situation) and, on the other hand, the tax treatment of the income and capital of the partners in a partnership who have exercised their right of freedom of establishment in a Member State where the level of taxation is higher than that provided for by the AStG (cross-border situation).

26 — Case C-446/04 [2006] ECR I-11753.

1. Comparison between the situation of the partners in Columbus and a domestic situation

72. It seems to me to be useful, particularly in order to clarify the reasoning, to distinguish between the avoidance of double taxation of income, provided for in Paragraph 20(2) of the AStG, and the avoidance of double taxation of capital, referred to in Paragraph 20(3).

(a) Comparison in relation to the double taxation of income (Paragraph 20(2) of the AStG)

73. There is no doubt that application of the method, substituted unilaterally by the Federal Republic of Germany for the exemption method provided for in the double taxation convention between that Member State and the Kingdom of Belgium, of offsetting the tax levied on Columbus in Belgium against the tax levied on its partners' income has led to a significant increase in their taxation in the tax year in question (1996) as compared with the preceding tax year.

74. Contrary to what Columbus has claimed several times, this unfavourable treatment per se does not constitute a restriction on freedom of establishment.

75. Indeed, Community law does not guarantee, in a sphere in which the Member States remain competent, application and retention over time of identical treatment for the same taxpayer. If that were the case, Member States would no longer be able to alter the basis or rate of their direct taxes, for example. This is impossible in the current state of development of Community law. The fact that the tax treatment given to the partners in Columbus was altered by the unilateral introduction of a derogation from the double taxation convention between the Federal Republic of Germany and the Kingdom of Belgium is due to a (possible) conflict between rules of domestic law and rules of international law, but in my view has nothing to do with Community law. In fact, as I observed in point 46 above, it does not fall to the Court to resolve such a conflict of rules.

76. Contrary to what Columbus also appears to suggest, a difference in treatment under Community law is not measured in the light of a factual or legal change in the situation of one and the same person. It requires rather a comparison between the situation of persons who have exercised one of the freedoms granted by the Treaty and that of persons who have not done so.

77. In that regard it will be noted that neither the referring court, which is inclined

rather to consider the German tax measure in question as a restriction on freedom of establishment, nor Columbus have identified any difference in treatment between the situation of the latter's partners and a domestic situation.

78. However, the German, Belgian, Netherlands, Portuguese and United Kingdom Governments and the Commission observe that the offsetting, referred to in Paragraph 20(2) of the AStG, of the tax levied on Columbus in Belgium against the income tax payable by its partners amounts to treating the latter in the same way as German taxpayers who are partners in partnerships with fiscal transparency located in Germany and who have not exercised their right of freedom of establishment in another Member State.

79. This line of argument seems to be correct.

80. It will be noted that by virtue of the second indent of Article 220 of the EC Treaty (now the second indent of Article 293 EC), Member States will, so far as necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals the abolition of double taxation within the Community.

81. That aspirational provision [27] has not so far been implemented, however. Moreover, apart from Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, [28] Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, [29] Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, [30] none of which is relevant here, no unifying or harmonising measure for the elimination of double taxation has yet been adopted at Community level, and Member States have not yet concluded any multilateral convention to that effect under the second indent of Article 220 of the EC Treaty. [31]

82. It follows that, in the absence of unifying or harmonising measures at Community level, the Member States retain competence for determining the criteria for taxation on income with a view to eliminating double taxation by means, inter alia, of

27 — Indeed, the provision has no direct effect: see *Gilly*, cited above, paragraph 17.

28 — OJ 1990 L 225, p. 6.

29 — OJ 1990 L 225, p. 10.

30 — OJ 2003 L 157, p. 38.

31 — See, in particular, with regard to the free movement of capital, *Kerckhaert and Morres*, cited above, paragraph 22, and as regards Article 52 of the EC Treaty, Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paragraph 51.

conventions.[32] In those circumstances, the Court initially stated that the Member States remained at liberty to determine the connecting factors for the allocation of fiscal jurisdiction *by means of bilateral agreements.*[33] In later judgments it added that this freedom granted to Member States extended to measures adopted unilaterally.[34]

83. However, as far as *the exercise of the power of taxation* is concerned, the Member States are obliged to comply with the provisions of Community law.[35]

84. The current case-law of the Court therefore draws a distinction between, on the one hand, *the allocation of fiscal jurisdiction* between Member States, where any differences in treatment which may result do not fall within the scope of the Treaty's freedoms of movement, and, on the other hand, *the exercise of the power of taxation by the Member States,* including when it results from an earlier bilateral or multilateral allocation of their power of taxation so allocated is concerned, in which the Member States must comply with the Community rules.[36]

85. It would appear to result from this dichotomy that Member States retain not only, on the one hand, the opportunity not to avoid double taxation,[37] but also, on the other hand, the choice of the mechanism for avoiding double taxation, which should, in principle, allow them in particular to opt either for the exemption method or for the method of offsetting tax levied in another Member State.

86. It should be noted in that regard that the Court has held that it was not unreasonable for the Member States to base their agreements on international practice, in particular the model tax conventions drawn up by the OECD.[38] It is clear from Article 23 of the

32 — *Gilly*, cited above, paragraphs 24 and 30, and Case C-385/00 *De Groot* [2002] ECR I-11819, paragraph 93, as regards Article 48 of the EC Treaty (now, after amendment, Article 39 EC). Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 57, as regards Articles 52 and 58 of the EC Treaty, and Case C-513/03 *Van Hilten-van der Heijden* [2006] ECR I-1957, paragraph 47, as regards free movement of capital.

33 — *Gilly*, cited above, paragraphs 24 to 30; *Saint-Gobain ZN*, cited above, paragraph 57; *De Groot*, cited above, paragraph 93; Case C-290/04 *FKP Scorpio Konzertproduktionen* [2006] ECR I-9461, paragraph 54; *Test Claimants in Class IV of the ACT Group Litigation*, cited above, paragraph 52 (emphasis added).

34 — With regard to free movement of capital, *Van Hilten-van der Heijden*, cited above, paragraph 47, and with regard to freedom of establishment, *N*, paragraph 44, and *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 52.

35 — *De Groot*, paragraph 94, and *FKP Scorpio Konzertproduktionen*, paragraph 55.

36 — *De Groot*, cited above, paragraphs 93 and 94.

37 — See, inter alia, in that regard, *Keckhaert and Morres*, cited above, paragraph 24, concerning the applicability of the free movement of capital, in which the Court held that Article 73b(1) of the Treaty does not preclude legislation of a Member State which, in the context of tax on income, makes dividends from shares in companies established in the territory of that State and dividends from shares in companies established in another Member State subject to the same uniform rate of taxation, without providing for the possibility of setting off tax levied by deduction at source in that other Member State.

38 — See *Gilly*, cited above, paragraphs 30 and 31, and *Saint-Gobain ZN*, cited above, paragraph 57.

Model Tax Convention on Income and on Capital that the exemption method and the set-off method are considered to be valid mechanisms for the avoidance or reduction of double taxation.

87. The Court has also been called upon to hear several cases in which the tax laws of the Member States at issue applied one or other of those methods, but it has not made any comment on the legality per se of the methods or of the choice of either of them in the light of Community law. [39]

88. However, it is also clear from the dichotomy outlined in point 84 above that, regardless of which procedure is adopted in order to avoid double taxation, Member States must comply with the requirements laid down in the Treaty provisions concerning the freedoms of movement, since they cannot exercise their powers of taxation in such a way that they treat situations that are objectively comparable in different ways.

89. Thus, the Court has held that Community law does not prohibit a Member State from avoiding the imposition of a series of charges to tax on dividends received by a resident company by applying rules which exempt those dividends from tax when they are paid by a resident company, while preventing, through a set-off system, those dividends from being liable to a series of charges to tax when they are paid by a non-resident company, where in such a situation application of the set-off system is compatible with Community law. [40]

90. In order for the application of that system to be compatible with Community law in such a situation, the Court has held that it is necessary, first of all, that the foreign-sourced dividends are not subject to a higher rate of tax than the rate which applies to nationally-sourced dividends and, secondly, that the Member State must prevent foreign-sourced dividends from being liable to a series of charges to tax, by offsetting the amount of tax paid by the non-resident company making the distribution against the amount of tax for which the recipient company is liable, up to the limit of the latter amount. [41]

91. Against that background, the Court added that the mere fact that, compared with an exemption system, a set-off system imposes additional administrative burdens on taxpayers (with evidence being required as to the amount of tax actually paid in the State in which the company making the distribution is resident) cannot be regarded

39 — See, inter alia, Case C-319/02 *Manninen* [2004] ECR I-7477.

40 — *Test Claimants in the FII Group Litigation*, cited above, paragraphs 48 and 49.

41 — Ibid., paragraphs 48 to 50.

as a difference in treatment which is contrary to freedom of establishment, since particular administrative burdens imposed on resident companies receiving foreign-sourced dividends are an intrinsic part of the operation of a tax credit system. [42]

92. In the present case, it should be noted that, in the situation of the partners in Columbus and of partners resident in Germany of partnerships located in Germany, the profits made by the partnership are directly allocated to the partners and are regarded as their income. Moreover, they are taxed during the same tax year and at the same rate in Germany.

93. Under the set-off method, the tax levied in Belgium on profits made by Columbus is the subject of a tax credit accruing to its partners in Germany and corresponding to the tax it has paid in Belgium. Whereas, before the tax year in question, application of the double taxation convention between the Federal Republic of Germany and the Kingdom of Belgium ensured that the partners in Columbus would enjoy a tax exemption in Germany on the profits they made in Belgium, replacement of the exemption method by the set-off method from that tax year onwards cancelled out the tax advantage that the partners had previously enjoyed as compared with partners in partnerships who were all domiciled in Germany and had not exercised the freedom of establishment provided for by the Treaty.

94. Thus, as regards comparison of the situation of the partners in Columbus and the partners in a partnership established in Germany, offsetting the tax levied on Columbus in Belgium against the income tax to be paid in Germany by its partners guarantees equal treatment as regards taxation both of income of foreign origin and income of German origin.

95. Admittedly, it will be noted that this statement is valid only if one includes in the consideration of the comparison of the situations at issue solely 'designated passive income' within the meaning of Paragraph 8 of the AStG. As regards income which is not designated passive income, the rule which applies is that of exemption of profits made by the partnership abroad, under the provisions of the double taxation convention between the Federal Republic of Germany and the Kingdom of Belgium.

96. Such exemption of designated passive income is likely to encourage establishment or investment abroad rather than at home. However, the use of methods to avoid double

42 — Ibid., paragraph 53.

taxation that differ according to the nature of the income in question cannot be criticised per se. At the current stage of development of Community law, whilst the Member States remain competent to define the tax base, [43] they should also in my view be in a position to apply various methods for avoiding double taxation, depending on the nature of the income, provided they comply with the Treaty provisions on freedom of movement. In the present case, as stated above, offsetting the tax levied on Columbus's profits against that levied on the income of its partners, who are German residents, ensures equal treatment with a comparable domestic situation.

97. Admittedly, the set-off method, unlike the exemption method, involves additional administrative charges for the partners in Columbus. However, those charges, as the Court held in *Test Claimants in the FII Group Litigation*, cited above, are inherent in the application of this mechanism for avoiding double taxation.

98. In this context, application of the set-off method in the main proceedings does not appear to create a difference in treatment between the partners in Columbus and the situation of German taxpayers who are partners in a partnership located in Germany, receiving the same type of income, who have not exercised their right of freedom of establishment under the Treaty.

(b) Comparison with avoidance of double taxation of capital (Paragraph 20(3) of the AStG)

99. Tax on capital, in common with tax on income, is based on the taxpayer's ability to pay. The tax payable is calculated on the basis of the assets owned by the taxpayer when it accrues.

100. Tax on capital is different from tax on income, however, because only some of the Member States apply it. [44]

101. Therefore, during the tax year at issue in the main proceedings, the Kingdom of Belgium did not levy any tax on capital,

43 — See, inter alia, *Test Claimants in the FII Group Litigation*, cited above, paragraph 47.

44 — At the relevant time in the main proceedings, only the Federal Republic of Germany, the Kingdom of Spain, the French Republic, the Grand Duchy of Luxembourg, the Kingdom of the Netherlands, the Republic of Finland and the Kingdom of Sweden levied tax on capital of natural persons. Since then, those Member States, apart from the Kingdom of Spain, the French Republic and the Kingdom of Sweden have abolished it.

including on the assets of permanent establishments, whilst the Federal Republic of Germany applied, for the last time, tax on capital on all the assets of German taxpayers, wherever those assets were located.[45]

102. Under the double taxation convention between the Federal Republic of Germany and the Kingdom of Belgium, capital comprising the assets of a permanent establishment is taxable in the State in which that establishment is located, and double taxation of those assets is avoided, as regards the assets of German taxpayers, by exemption of the tax on capital levied in Germany.[46]

103. Because the Kingdom of Belgium does not levy any tax on capital, before the tax year in question Columbus's assets were totally exempt from tax on capital under that convention.

104. With reference to Paragraph 20(2) of the AStG as regards taxation of the designated passive income of the partners in Columbus, in order to avoid double taxation of the assets of a permanent establishment giving rise to designated passive income within the assets of German taxpayers, Paragraph 20(3) replaces the exemption method by the method of offsetting tax levied abroad. This mechanism therefore includes in the calculation of the tax on capital of the partners in Columbus, the latter's assets giving rise to designated passive income within the meaning of the AStG.

105. Replacement, for purposes of avoidance of double taxation, of the exemption method by the set-off method thus led to taxation in Germany, in respect of the assets of the partners in Columbus, of Columbus's assets that had given rise to designated passive income within the meaning of the AStG.

106. As in my analysis in respect of income tax, I consider that application of the set-off method in the situation at issue in the main proceedings did not lead to a difference in treatment in relation to a comparable situation which had only applied in the country concerned. In both cases, the partners in the permanent establishment are liable to payment of the same tax, with the same basis and the same rate.

45 — At the relevant time in the main proceedings, this tax in the case of natural persons was 0.5% of taxable business assets.

46 — See Articles 22 and 23 of that Convention.

(c) Interim conclusion

107. In the light of the above considerations, a provision such as that contained in Paragraph 20(2) and (3) of the AStG does not appear to constitute a restriction on freedom of establishment provided that assessment is limited to a comparison between German nationals who have exercised their right of freedom of establishment and those which have not exercised that right.

108. However, as I identified in points 67 to 70 above, it would appear necessary in the light of *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, to consider also whether a restriction on the freedom of establishment of German nationals does not result from a difference in treatment, under Paragraph 20(2) and (3) of the AStG, between a situation such as that of the partners in Columbus and another cross-border situation, that is to say, more specifically, where the right of freedom of establishment has been exercised in a Member State where the level of taxation is higher than that provided for in the AStG.

2. Comparison between the situation of the partners in Columbus and another cross-border situation

109. Before considering the conclusions to be drawn from that judgment in the present case, it is appropriate first of all to note in detail the assessment made by the Court with regard to the existence of a restriction on freedom of establishment resulting from application of the United Kingdom legislation on CFCs.

(a) *Cadbury Schweppes and Cadbury Schweppes Overseas*

110. It will be remembered that in the above case Cadbury Schweppes, established in the United Kingdom, had set up a subsidiary in Ireland, in the Dublin International Financial Services Centre (IFSC), which was subject to a tax rate of 10% at the relevant time in the main proceedings. That subsidiary had been formed solely in order that the profits related to the internal financing activities of the Cadbury Schweppes group could benefit from the tax regime of the IFSC. The United Kingdom tax authorities claimed from Cadbury Schweppes a sum in excess of GBP 8 million in corporation tax in respect of the profits made by its subsidiary in Ireland, under the United Kingdom legislation on CFCs.

111. That legislation provides for an exception to the general rule applying in the United Kingdom that a company established in the United Kingdom is not taxed on the profits of a subsidiary as they arise. More specifically, under the general rule applying in the United Kingdom, a company which is established in that Member State and which forms a subsidiary there is not taxed either on the profits made by the latter or on the dividends which that subsidiary has distributed to it. Again according to the general rule, a company established in the United Kingdom which has formed a subsidiary in another Member State is taxed on the dividends distributed by that subsidiary, but enjoys a tax credit up to the amount of the tax which that subsidiary paid on profits made abroad. By way of derogation from the general rule just stated, the United Kingdom legislation on CFCs provides in principle that a resident company is taxed on the profits made by its subsidiary established in another Member State applying a 'lower level of taxation', namely tax that is less than three quarters of the amount of tax which would have been paid in the United Kingdom on the taxable profits as they would have been calculated for the purposes of taxation in that Member State.

112. It was in the light of those circumstances that the Court described the United Kingdom legislation on CFCs as a restriction on freedom of establishment.

113. In paragraphs 43 to 45 of that judgment, the Court noted the difference in treatment that existed between, on the one hand, a company established in the United Kingdom which had set up a CFC (subsidiary) in another Member State, where that subsidiary was subject to a lower level of taxation within the meaning of the legislation on CFCs and, on the other hand, a company established in the United Kingdom which either controlled a subsidiary in that State or had set up a controlled company in another Member State, where that subsidiary was not subject to a lower level of taxation within the meaning of the legislation on CFCs. While in the first situation the profits made by the CFC were allocated to the company established in the United Kingdom, which was taxed on those profits, in the other two situations the resident company was not taxed on the profits of the controlled subsidiary, in accordance with the United Kingdom legislation on corporation tax. In the view of the Court, that difference in treatment creates a tax disadvantage for the resident company to which the legislation on CFCs is applicable, since under such legislation the resident company is taxed on profits of another legal person, irrespective of the fact that that company is not paying tax that is higher than that which would be payable on the profits concerned if they had been made by a subsidiary established in the United Kingdom.

114. As stated above, it will be noted with interest that the premiss which the Court takes as the basis for its description of the United Kingdom legislation on CFCs as being restrictive of freedom of establishment is not only what is after all a traditional comparison between a cross-border situation and a domestic situation. The basis is also a more original comparison between two

cross-border situations, depending on whether the resident company has set up a controlled company in a Member State other than the United Kingdom, applying a level of taxation that is lower or higher than that provided for by the United Kingdom legislation on CFCs.

115. The reason for the introduction of this second part of the comparison criterion (cross-border situations compared between themselves), which is not mentioned in *Cadbury Schweppes and Cadbury Schweppes Overseas*, originates most probably from the Opinion of Advocate General Léger in that case.

116. In his Opinion, the Advocate General had said that he did not understand why, contrary to the case made by the United Kingdom of Great Britain and Northern Ireland, the situation of Cadbury Schweppes could not be compared to that of resident companies which had also exercised the right of establishment by forming subsidiaries in Member States where the level of taxation was higher than that provided for in the United Kingdom legislation on CFCs. In that regard, he rejected the argument that the disparity in the rates of corporation tax in effect within the Member States constitutes an objective difference in situation justifying the differentiated treatment laid down by the legislation on CFCs. In the view of the Advocate General, if that argument were to be followed through, it would be tantamount to conceding that a Member State is entitled, without infringing the rules of the Treaty, to choose the other Member States in which its domestic companies may establish subsidiaries and benefit from the tax regime applicable in the host State. However, such a situation would manifestly lead to a result that would be contrary to the notion of 'single market'. Advocate General Léger therefore suggested that the difference in treatment depending on the tax rate of the Member State of establishment alone sufficed for the system provided for under the United Kingdom legislation on CFCs to be regarded as constituting a hindrance to freedom of establishment. [47]

117. The risk of fragmentation of the common market generated by national provisions such as those of the United Kingdom legislation on CFCs thus appears to lie at the origin of the Court's acceptance of the objective comparability between, on the one hand, the situation of a resident company that has set up a subsidiary in a Member State with a lower level of taxation than that provided for by the United Kingdom legislation on CFCs and, on the other hand, the situation of a resident company which has set up a subsidiary in a Member State in which the level of taxation is higher than that provided for by that same legislation. In both those situations there is a company which intends to exercise its right of establishment in the Member State of its choice.

47 — See the Opinion in *Cadbury Schweppes and Cadbury Schweppes Overseas*, points 78 to 83.

118. That solution does not appear to me to be open to criticism in itself. It is moreover consistent with the existence of an internal market which, under Article 3(1)(c) of the EC Treaty (now, after amendment, Article 3(1)(c) EC), is a feature of the Community's activities. The approach adopted by the Court raises two types of difficulty, however.

119. First, it is not entirely clear whether the two parts of the comparison criteria used by the Court in *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, are to be applied individually or cumulatively. In other words, the question could be raised as to whether a difference in treatment, provided for by the national legislation of the taxpayer's Member State of residence, which applies solely between two cross-border situations, is sufficient in order to consider that a restriction on freedom of establishment exists. [48]

120. In the light of the abovementioned Opinion of Advocate General Léger, and from reading paragraphs 44 and 45 of the Court's judgment, it would appear that this question should be answered in the affirmative.

121. Indeed, the fact that in those paragraphs of the judgment in question the Court used the conjunction 'or' when it identified the two situations in the light of which the position of the resident company subject to the United Kingdom legislation on CFCs should be compared, appears to support the view taken by Advocate General Léger in the abovementioned Opinion. If that is the approach favoured by the Court it could lead, within the scope of freedom of establishment, to situations which, on the basis merely of a comparison between a cross-border situation and a domestic situation within the Member State of residence, would not fall within the scope of freedom of establishment or would not restrict that freedom.

122. Secondly, and in relation to this, it is a question of whether, assuming that a difference in treatment between two cross-border situations introduced by a taxpayer's Member State of residence is the only reason why a tax measure is regarded as a restriction on freedom of establishment, that approach can be extended to cover a situation which, although showing similarities with the circumstances at issue in *Cadbury Schweppes and Cadbury Schweppes Overseas*, differs from it in several respects, in particular as regards the nature of the tax measure in question, that is to say, a measure to avoid double taxation.

123. Those two queries are indeed raised in this case.

48 — A difference in treatment that would apply only between a domestic situation and a cross-border situation, provided the situations in question are comparable, would of course infringe the right of freedom of establishment. This part of the alternative does not raise any particular problem.

124. I now come to the conclusions that may be drawn for the present case from the assessment made by the Court in paragraphs 43 and 45 of *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above.

(b) Comparison in relation to the avoidance of double taxation of income (Paragraph 20(2) of the AStG)

125. As stated above, application of the set-off method, within the meaning of Paragraph 20(2) of the AStG, assumes mainly that the tax levied abroad is below the level provided for by the AStG, that is to say, less than 30% of profits. In principle, therefore, Paragraph 20(2) of the AStG is not intended to apply where designated passive income derives from permanent establishments of German residents which are located in Member States where the level of taxation is equal to or above 30%. In that case, it is the method of exemption of the tax levied abroad which should in principle apply.

126. The German Government contends that the difference which exists between the situation of the partners in Columbus and the tax situation of the partners in a permanent establishment located in a Member State where the level of taxation is higher than the rate provided for by the German tax legislation results solely from the fact that the fiscal regulations of the Member States exist side by side. Such a difference would in itself not fall within the Treaty provisions concerning the freedoms of movement.

127. These arguments are not convincing.

128. The unfavourable tax treatment in the present case does not result purely from application of the different tax legislations of the Member States, but from the choice made in the German tax legislation [49] to set the mechanism for off-setting tax levied abroad on the income in question in motion where that tax is below the 30% level provided for by the AStG.

129. It would be different in my view if the replacement of the exemption method by the set-off method, decided by the Federal Republic of Germany, applied irrespective of the rate at which the income in question was taxed in Germany. In that situation, any unfavourable treatment caused by application of that method to similar income of German taxpayers derived from permanent

49 — See to that effect the Opinion of Advocate General Geelhoed in *Test Claimants in the FII Group Litigation*, cited above, point 39.

establishments located abroad would depend essentially on the level of tax levied in each of the Member States. It would in that case be unfavourable treatment arising from the coexistence of the different tax legislations of the Member States. However, that is certainly not the case here.

130. The question is thus whether this unfavourable treatment nevertheless constitutes a difference in treatment prohibited by Article 52 of the EC Treaty.

131. It seems it cannot be denied that one of the effects of the application of Paragraph 20(2) of the AStG — which is discounted, incidentally, by the German legislature — is that it cancels out the tax advantages obtained by German taxpayers who have already established or are wanting to establish themselves in Member States where the tax levied on designated passive income derived from a partnership which is a permanent establishment abroad is below the rate of 30% provided for in the AStG.

132. In this respect, as the representatives of Columbus and of the Belgian Government suggested at the hearing, this national measure, like that at issue in *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, might be regarded as having the effect of fragmenting the common market, by encouraging German nationals to establish themselves only in Member States where the level of taxation is equal to or above the German rate provided for in the AStG. Following that line of reasoning, this measure would therefore be likely to deter German nationals from setting up, acquiring or maintaining a permanent establishment in a Member State in which it is subject to a level of taxation below 30%.

133. In that regard, the fact that Paragraph 20(2) of the AStG does not treat the partners in Columbus differently from partners in a partnership established in Germany is irrelevant. As I stated in points 120 and 121 above, it seems to me that the judgment in *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, in the light of the Opinion of Advocate General Léger, may be interpreted as meaning that a Member State of residence cannot restrict the freedom of establishment of its nationals to part of the common market, inter alia when there is no difference between that Member State's treatment of domestic situations and cross-border situations. Thus, the obligation on the 'exit' State (in other words, the State of residence), in this case the Federal Republic of Germany, is to ensure, in addition to respect for equal treatment among its residents as regards whether they have or have not exercised their freedom of movement, that they are not deterred from establishing themselves in the Member State of their choice, inter alia by means of tax measures.

134. The German Government objected to this line of reasoning, inter alia at the hearing. Whilst accepting that the tax measure in question does apply different treatment depending on whether German nationals wish to establish themselves or invest in a Member State where the level of taxation is lower or higher than the rate provided for in the AStG, the Federal Republic of Germany contends that such a difference is not prohibited by the Treaty because the situations at issue are not objectively comparable. In that regard, that Member State refers inter alia to the judgment in *D*, [50] in which the Court did not allow the provisions of bilateral double taxation conventions to be extended to natural or legal persons not falling within the scope of those conventions.

135. At first sight, that line of argument could be rejected by reference to the judgment in *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, which accepted that the situation of a parent company established in the United Kingdom with a subsidiary established in a Member State where the level of taxation was lower than that provided for by the United Kingdom legislation on CFCs was objectively comparable to that of a parent company of that State whose subsidiary was established in a Member State where the level of taxation was higher than that provided for by that legislation.

136. However, the reasoning put forward by the German Government warrants closer consideration.

137. Although formulated in a slightly different way, this argument appears to suggest that if the objectively comparative nature of two cross-border situations such as those discussed in the present case were recognised, it would mean that where a Member State applies the exemption method under a double taxation convention as regards taxation of designated passive income of its nationals derived from a permanent establishment located in another Member State, that State would also be bound to apply that method of avoiding double taxation in its relations with all the other Member States in respect of the same type of operation.

138. The Court has held on several occasions that the scope of a bilateral tax convention is limited to the natural or legal persons referred to in it, [51] stating that the fact that those reciprocal rights and obligations apply only to persons resident in one of the two Contracting Member States is an

50 — Case C-376/03 [2005] ECR I-5821.

51 — *D*, cited above, paragraph 54, and *Test Claimants in Class IV of the ACT Group Litigation*, cited above, paragraph 84.

inherent consequence of bilateral double taxation conventions.[52]

139. Despite that principle, the Court has also accepted that there are situations in which the advantages of a bilateral convention may be extended to a resident of a State which is not party to that convention.

140. The Court has thus held that, in the case of a double taxation convention concluded between a Member State and a non-member country, the national treatment principle requires the Member State which is party to that convention to grant to permanent establishments of non-resident companies the benefits provided for by that convention on the same conditions as those which apply to resident companies.[53] In such a case, the non-resident taxable person having a permanent establishment in a Member State is regarded as being in a situation equivalent to that of a taxable person resident in that State.[54]

141. The case-law on this point is therefore less clear-cut than the German Government appears to contend.

142. In the judgment in *Saint-Gobain ZN*, cited above, which concerns tax concessions relating to the taxation of shareholdings and dividends, it appears that the infringement of Community law arose as a result of the Member State of residence applying the registered office or the residence criterion differently depending on whether it was a matter of determining the liability to tax of resident companies and non-resident companies which pursued their activities in that State through a permanent establishment, or of granting the concessions linked to it, which were refused solely to the latter companies. Those companies could therefore be objectively compared to companies which were established in the Member State concerned.

143. In *D* and *Test Claimants in Class IV of the ACT Group Litigation*, cited above, the Court refused to accept extension of the tax advantages granted to non-resident natural and legal persons by the State of the source of the capital and income concerned, under the provisions of double taxation conventions concluded with the State of residence of those persons, to other non-residents liable to tax in a Member State that was not party to those conventions. The situation of those non-residents was not objectively comparable.

144. If this interpretation of the case-law is correct I do not think that the Federal Republic of Germany can rightfully contend that its own residents, which are in principle

52 — *D*, cited above, paragraph 61, and *Test Claimants in Class IV of the ACT Group Litigation*, cited above, paragraph 91.

53 — *Saint-Gobain ZN*, cited above, paragraph 59, and *D*, cited above, paragraph 56.

54 — *D*, paragraph 57.

taxed on the basis of their worldwide income in that Member State, are in an objectively different situation depending on whether they receive income derived from a Member State where the level of taxation is lower or higher than the rate provided for in the AStG.

145. Lastly, at the hearing the German Government, supported by the Netherlands and the United Kingdom Governments, argued that this case differs in various respects from *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, which should lead the Court to depart from it. The representatives of those governments cited in that regard the nature of the tax measure in question in this case and the fact that the criterion regarding allocation of the profits made by the permanent establishment to another legal person did not exist in this case.

146. As regards the first point, it is correct that, unlike in *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, the tax measure at issue in the present case is designed to avoid double taxation of designated passive income within the meaning of the AStG which derives from a cross-border activity, by replacing the exemption method provided for by the double taxation convention between the Federal Republic of Germany and the Kingdom of Belgium by the set-off method.

147. One might then consider that, both in the situation where the permanent establishment is located in a Member State where the level of taxation is higher than the German rate and in the situation where, as in the case in the main proceedings, it is located in a Member State where the level of taxation is lower than the German rate, the Federal Republic of Germany does not avoid, for its residents, double taxation of designated passive income deriving from permanent establishments located in other Member States. In this regard, the objective of avoidance of double taxation appears to be achieved.

148. The fact remains that the German taxpayer is deterred from establishing himself or maintaining an establishment in a Member State where the level of taxation is lower than that provided for by the AStG. It seems to me that, in view of the fragmentation of the internal market caused by the tax measure in question, which is moreover an effect sought by the German legislature, such a measure should not be considered to be compatible with freedom of establishment as ensured by the Treaty, unless it is justified by a public interest requirement.

149. As regards the second point, I also consider that the difference identified by the German Government is eclipsed by the more fundamental principle which requires Member States to refrain from taking unilateral measures to split up the internal market unless such a measure is justified by a public interest objective.

150. I therefore consider that a national measure such as Paragraph 20(2) of the AStG is likely to constitute a restriction on freedom of establishment provided for in the Treaty.

(c) Comparison in relation to the avoidance of double taxation of capital (Paragraph 20(3) of the AStG)

151. A similar view may be taken in my opinion as regards tax on capital.

152. It could moreover be argued that the deterrent effect is, in this situation, even stronger than as regards the application of Paragraph 20(2) of the AStG.

153. In a situation like that in the main proceedings, in which the Kingdom of Belgium does not levy a tax on capital, application of the set-off method merely allows the Federal Republic of Germany to levy its own tax on capital since there will be no foreign tax to offset against the German tax.

154. In a situation in which the permanent establishment is located in a Member State where taxation is higher than the rate provided for in the AStG but no tax on capital is levied, German partners will not in principle be liable to pay tax on capital in Germany, since the exemption method applies.

155. Therefore, in my view, by treating comparable situations differently, Paragraph 20(3) of the AStG also restricts the exercise of the freedom of establishment provided for in the Treaty.

3. Conclusion regarding the existence of a restriction on freedom of establishment

156. In the light of the above considerations, I am of the view that a national provision such as that contained in Paragraph 20(2) and (3) of the AStG constitutes a restriction on the freedom of establishment provided for by the Treaty, since it is likely to deter German nationals from establishing themselves freely in another Member State of their choice.

157. In those circumstances, it is necessary to consider whether such a restriction can be justified.

D — *Justifications for the restriction on freedom of establishment*

158. According to the case-law, a restriction on freedom of establishment is permissible only if it is justified on the grounds set out in Article 56 of the EC Treaty (now, after amendment, Article 46 EC) or by overriding reasons of public interest. In any event, the restriction must be appropriate to ensuring the attainment of the legitimate objective thus pursued and not go beyond what is necessary to attain that objective. [55]

159. Before the referring court, the Finanzamt Bielefeld-Innenstadt claimed that Paragraph 20(2) and (3) of the AStG is justified in order to counteract harmful tax competition, to prevent wholly artificial arrangements and to safeguard the cohesion of the tax system. Those three justifications were reiterated by the German Government in its written observations lodged with the Court of Justice.

160. The Netherlands Government and the Commission support in essence the observations of the German Government, considering that the provisions of Paragraph 20(2) and (3) of the AStG are justified, however, solely by the concern to prevent wholly artificial arrangements designed to circumvent the German tax legislation. For its part, the Portuguese Government considers that that paragraph seeks to protect the cohesion of the German tax system.

161. Columbus and the Belgian Government, on the other hand, consider that the national rules at issue cannot be justified on any of the grounds put forward before the referring court and the Court of Justice.

162. The three grounds of justification put forward by the German authorities should be considered in turn.

1. Counteracting harmful tax competition

163. The Federal Republic of Germany points out, on the one hand, that the Belgian

55 — See to that effect, Case C-167/01 *Inspire Art* [2003] ECR I-10155, paragraphs 107, 132 and 133; *De Lasteyrie du Saillant*, cited above, paragraph 49; *Marks & Spencer*, cited above, paragraph 35; and *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, paragraph 47.

system of coordination centres was referred to, in a resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council,[56] as one of the harmful tax competition measures and, on the other hand, that the Commission initiated a formal investigation procedure against it in order to establish whether that system included elements of State aid. That Member State considers none the less that, irrespective of those initiatives, Paragraph 20(2) and (3) of the AStG is designed to enable it, as part of its right of 'self-defence', to offset the extraordinary tax advantages afforded by that system by restoring the tax burden of Columbus's partners to the German level of taxation using the set-off method.

164. Worded in this way, the objective stated by the Federal Republic of Germany appears to have become confused with an alleged right to offset a tax advantage acquired in another Member State by applying unfavourable tax treatment.

165. However, such an objective cannot be accepted in order to justify a restriction on freedom of establishment, as is clear from the case-law.[57]

166. As Advocate General Léger rightly noted in his Opinion in *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, in the absence of Community harmonisation, it must be accepted that there is competition between the tax regimes of the various Member States.[58] It may be a matter for regret that such competition operates without restriction. That question, as is also accepted in the preamble to the Council Resolution cited by the Federal Republic of Germany, calls, however, for an answer of a political nature and therefore has no effect on the rights and obligations of Member States under the Treaty.

167. I am also of the opinion that the fact that the tax system at issue may be classified as State aid incompatible with the common market[59] and it is incumbent on the Commission, under the Treaty, to check such compatibility, cannot therefore entitle a Member State to take unilateral measures against that system, intended to counter its effects, which would infringe one of the fundamental freedoms provided for by the Treaty.[60]

56 — Resolution of 1 December 1997 on a code of conduct for business taxation (OJ 1998 C 2, p. 2).

57 — See, inter alia, *De Groot*, cited above, paragraph 97, and *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, paragraph 49 and case-law cited.

58 — Point 55 of the Opinion.

59 — I would point out that this system actually involves State aid, as the Court held in *Belgium and Forum 187* v *Commission*, cited above.

60 — See, to that effect, point 58 of the Opinion of Advocate General Léger in *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above.

168. Hence the need to counteract harmful tax competition is not, in my view, an appropriate justification for the restriction on the freedom of establishment at issue in the present case.

2. Prevention of wholly artificial arrangements

169. The Federal Republic of Germany also argues that the prevention of wholly artificial arrangements was a factor in the adoption of Paragraph 20(2) and (3) of the AStG by the German legislature. It contends that this justification has been accepted in the case-law of the Court. It considers none the less that this case-law is too restrictive and proposes that the Court should extend the right of Member States to prevent artificial arrangements by allowing them to require that permanent establishments formed in another Member State in order to benefit from tax advantages there should become integrated in an effective and lasting manner into the economic life of that State. Such integration does not exist, in the view of the Federal Republic of Germany, in the case of Belgian coordination centres, as in the main proceedings.

170. As the Federal Republic of Germany contends, the Court has accepted on several occasions that a tax measure which restricts the exercise of a fundamental freedom guaranteed by the Treaty may be justified if that measure has the specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose is to circumvent or escape the law of the Member State concerned. [61]

171. In *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, the Court provided some clarification concerning assessment of the existence of such arrangements, inter alia, in order to enable the national court to determine whether the United Kingdom legislation on CFCs was proportionate.

172. It is clear therefore from that judgment that, in order to find that there is a wholly artificial arrangement, there must be, in addition to a subjective element consisting in the intention to obtain a tax advantage, objective factors which are ascertainable by third parties with regard, inter alia, to the extent to which the CFC physically exists in terms of premises, staff and equipment, showing that, despite formal observance of the conditions laid down by Community law, the objective of integration into the economic life of the host Member State pursued by freedom of establishment has not been achieved. [62]

61 — *ICI*, cited above, paragraph 26; *X and Y*, cited above, paragraph 61; Case C-324/00 *Lankhorst-Hohorst* [2002] ECR I-11779, paragraph 37; *De Lasteyrie du Saillant*, cited above, paragraph 50; *Marks & Spencer*, cited above, paragraph 57; and *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, paragraph 51.

62 — *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, paragraphs 64, 53 to 55 and 67.

173. The Court concluded from this that, in order for the United Kingdom legislation on CFCs to comply with Community law, the taxation provided for by that legislation must not be applied where, despite the existence of tax motives, the incorporation of a CFC reflects economic reality, namely it corresponds with an actual establishment intended to carry on genuine economic activities in the host Member State. [63]

174. The Court added that it was for the national court to determine whether one of the aspects of the United Kingdom legislation on CFCs which enabled a resident company to show essentially that the main reason or one of the main reasons for incorporating the CFC was not to avoid tax normally payable in the United Kingdom (the motive test) lent itself to an interpretation which enabled the taxation provided for by that legislation to be restricted to wholly artificial arrangements, leading to the conclusion that the legislation on CFCs is compatible with freedom of establishment. [64]

175. It can be seen from the latter clarification that the Court does not seem prepared to accept legislation of a Member State which excludes categorically and generally any allegedly artificial arrangement from the benefit of a tax advantage without allowing the national courts to make such a case-by-case analysis taking account of the particular features of each case, particularly on the basis of information provided by the taxpayer concerned. [65]

176. In the present case there is no reason why, in my opinion, the Court should not repeat the assessment it made in *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, with regard to examining the proportionality of the United Kingdom tax measure, since there is little doubt in the present case — and none of the parties which submitted observations to the Court has argued to the contrary — that replacement of the exemption method by the set-off method provided for in Paragraph 20(2) and (3) of the AStG is likely to achieve the objective pursued by the Federal Republic of Germany.

177. As regards therefore the proportionality of the measure at issue, which is mainly a matter for the referring court to consider, it is appropriate in my view to make the following observations.

178. Although the nature of the national measure at issue, namely the replacement of one method for avoidance of double taxation

63 — Ibid., paragraphs 65 and 66.

64 — Ibid., paragraphs 62, 72 and 73.

65 — See to that effect, *X and Y*, cited above, paragraph 43.

by another, less favourable method, is less prejudicial to freedom of establishment than liability to additional tax, the AStG does not in any way appear to allow, when all the general conditions for its application to which Paragraph 20(2) and (3) of the AStG refers are met, a case-by-case analysis to be made in order to determine whether in each particular case that provision need not be applied because a permanent establishment had actually been set up in the host Member State in question. In that regard, Paragraph 20(2) and (3) of the AStG appears to be based on an irrebutable presumption that a purely artificial arrangement exists when the conditions referred to in that provision are met. Such an approach appears to me to be disproportionate to the objective pursued, in the light of the considerations set out in points 174 and 175 above.

179. If, however, the referring court were to have sufficient freedom of action to assess whether a purely artificial arrangement existed in the case in the main proceedings, inter alia on the basis of other provisions of German tax law, it would be for it to determine whether Columbus had an actual establishment in Belgium intended to carry on genuine economic activities in that Member State, on the basis of objective and ascertainable factors relating, inter alia, to the extent to which Columbus physically existed in terms of premises, staff and equipment. It is only if that was not the case that the national measure at issue, as applied in the present case, would be justified in order to prevent wholly artificial arrangements.

180. With a view to (possible) consideration of those objective factors by the referring court, it is my view that that court should, in particular, determine whether, during the tax year in question, Columbus continued to meet all the conditions applying to coordination centres under abovementioned Royal Decree No 187 of 30 December 1982, including as regards the requirements concerning the level of employment in Belgium. [66]

181. Moreover, contrary to what the German Government implies, I do not think that the fact that an establishment such as Columbus devotes its activities to holding and managing capital and may, where necessary, make financial investments in other Member States, can be decisive as regards finding that a purely artificial arrangement exists, in so far as that establishment does not engage in actual economic activities in the host Member State.

182. Not only are financial activities excluded in principle from the freedoms of movement, it cannot be totally ruled out that

66 — Coordination centres must employ in Belgium the equivalent of at least 10 full-time staff once they have been in business for two years.

capital investments will be made by an establishment like Columbus for its partners in the host Member State or, at least, through financial or banking intermediaries established in Belgium.

183. I consider that these circumstances, combined with an actual physical establishment in the host Member State, are sufficient to rule out the existence of a purely artificial arrangement.

184. In any event, it is for the referring court to carry out all the necessary checks to determine whether Columbus had an actual establishment, within the meaning of the Court's case-law, thus enabling the national court to find that, in the case in the main proceedings, application of Paragraph 20(2) and (3) of the AStG could not be justified in order to prevent wholly artificial arrangements.

3. Protection of the cohesion of the tax system

185. The Federal Republic of Germany also defends Paragraph 20(2) and (3) of the AStG on the ground of protection of the cohesion of its tax system. In its view, that provision ensures taxation of the worldwide income (and capital) of German taxpayers with regard to capital investment or capital export neutrality, which correspond to the policy choice of the German legislature in accordance with its fiscal sovereignty.

186. Since *Bachmann*[67] and *Commission* v *Belgium*[68] the Court has in principle accepted that protection of the cohesion of the tax system is an objective on which Member States may rely in order to justify restrictions of the freedoms of movement provided for in the Treaty.

187. Although following the judgments in those two cases, the justification drawn from the need to ensure the cohesion of the tax system constitutes one of the overriding requirements of public interest most frequently relied on by Member States in connection with direct taxation, it has always been rejected by the Court, in particular on the ground that, unlike the situations giving rise to the two cases mentioned above, the tax rules at issue did not show there was a direct link between granting a tax advantage and off-setting that advantage by a tax

67 — Case C-204/90 [1992] ECR I-249, paragraphs 21 to 23.
68 — Case C-300/90 [1992] ECR I-305, paragraphs 14 to 16.

levy,[69] which requires in principle that the deduction and the levy must be made in relation to the same tax and the same taxpayer.[70]

188. If applied strictly, that case-law would result in rejection of the justification based on cohesion of the tax system in the present case, since the tax advantage in question granted to Columbus and the application of the set-off method occur in connection with separate taxes and separate tax systems.

189. In *Manninen*, cited above, the Court appears however to have relaxed the strict interpretation of the concept of cohesion of the tax system based on the criteria of the same tax and the same taxpayer which had applied in case-law up until then, accepting, as Advocate General Kokott suggested in her Opinion in that case, that a Member State could rely on the requirement to preserve the cohesion of the tax system, even though the two abovementioned criteria were not met in that case.[71]

190. The concept of cohesion of the tax system has been described as being 'rather diffuse'[72] or even 'mysterious'.[73] Member States have often relied on it in among other types of justification, often recognised as being overriding requirements for the purposes of the case-law, such as the effectiveness of fiscal supervision, combating tax evasion or tax fraud, or even the loss of tax revenue, which does not however come under those requirements.[74] In the present case, the Federal Republic of Germany also seems to regard this concept as being the same as the principle of territoriality contained in international tax law, a principle which has also been accepted by the Court as justifying a restriction on one of the freedoms of movement.[75]

191. As Advocate General Poiares Maduro stated in his Opinion in *Marks & Spencer*,[76] the function performed by fiscal cohesion is

69 — *ICI*, cited above, paragraph 29; *Baars*, cited above, paragraph 40; *De Groot*, cited above, paragraph 109; Case C-168/01 *Bosal* [2003] ECR I-9409, paragraph 31; Case C-242/03 *Weidert and Paulus* [2004] ECR I-7379, paragraph 22; Case C-39/04 *Laboratoires Fournier* [2005] ECR I-2057, paragraph 21; and Case C-345/05 *Commission* v *Portugal* [2006] ECR I-10633, paragraph 29.

70 — See in particular *Baars*, cited above, paragraph 40; Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraphs 57 and 58; *Bosal*, cited above, paragraphs 29 and 30; Case C-315/02 *Lenz* [2004] ECR I-7063, paragraph 36; *Manninen*, cited above, paragraph 42; and Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] ECR I-8203, paragraph 54.

71 — Paragraphs 45 and 46 of the judgment and, in particular, points 54 to 57 of the Opinion.

72 — Point 51 of the Opinion of Advocate General Kokott in *Manninen*, cited above.

73 — Vanistendael, F., 'Cohesion: The Phoenix rises from his ashes', *EC Tax Review*, 2005, p. 211.

74 — See in that regard, inter alia, *Verkooijen*, cited above, paragraph 59; *X and Y*, cited above, paragraph 50; *Lenz*, cited above, paragraph 40; and *Marks & Spencer*, cited above, paragraph 44.

75 — See Case C-250/92 *Futura Participations and Singer* [1997] ECR I-2471, paragraph 22; *Bosal*, cited above, paragraph 37; *Manninen*, cited above, paragraph 38; and *Marks & Spencer*, cited above, paragraph 39.

76 — Points 66 and 67.

the protection of the integrity of the national tax systems, provided that it does not impede the integration of those systems within the context of the internal market. In that regard, it seeks to ensure a 'delicate equilibrium' that may be conveyed by the idea of a 'twofold neutrality', that is to say, on the one hand, the fiscal neutrality required of Member States by Article 52 of the EC Treaty concerning the establishment of undertakings in the Community and, on the other hand, the fiscal neutrality which the exercise of the freedom of establishment must ensure for the tax arrangements adopted by the Member States, so that Community nationals do not use the provisions of Community law to secure advantages from it which are unconnected with the exercise of that freedom.

192. From that angle, it might therefore be suggested that the concept of cohesion of the tax system is being confused with abuse of the right or the requirement to prevent wholly artificial arrangements. If that were the case, it would be sufficient in the present case to refer to the considerations relating to that justification in this Opinion.

193. Given the near total rejection of the argument relating to safeguarding the cohesion of the tax system, even as accepted in a more flexible form in *Manninen*, cited above, and the difficulties of clearly defining that concept in relation to the other justifications put forward by Member States, [77] the question might be raised as to how useful it is.

194. This question doubtless arises due to the situations in which the Court has been required to evaluate this justification. In the cases in which the argument of the need for cohesion of the tax system had been raised more seriously, in one way or another, a difference in treatment was established under the national legislation concerned between a domestic situation and a cross-border situation in which the taxpayers concerned had exercised one of the freedoms of movement. In short, the legislation concerned did not allow an operation carried out in the Community to benefit from tax treatment in the form of a tax advantage reserved for operations of the same type carried out on national territory. [78] Thus, in *Manninen*, cited above, the Finnish legislation made the grant of a tax credit to shareholders resident in Finland with unlimited tax liability in that Member State conditional upon the dividends being distributed by companies established in Finland, which were subject to corporation tax in that State. When considering the proportionality

77 — Again, in *Marks & Spencer*, cited above, the Court, when considering the possible justification for the United Kingdom legislation which restricted the benefit of group relief to losses made by resident companies, did not refer to preserving the cohesion of the national tax system, but to a bundle of three cumulative pleas, alleging, first of all, protection of a balanced allocation of the power to impose taxes between the Member States, next, the risk of losses being taken into account twice and, lastly, the risk of tax avoidance.

78 — See, inter alia, the facts in *Verkooijen*, *Bosal*, *Lenz* and *Manninen*, all cited above, and in Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727.

of the tax measure at issue, which was intended to avoid double taxation of companies' profits distributed to shareholders, the Court held that the granting to Finnish shareholders of a company established in Sweden of a tax credit calculated by reference to the tax payable by that company in that Member State would not threaten the cohesion of the Finnish tax system and would constitute a measure less restrictive of the free movement of capital.[79]

195. As I have analysed it above, the tax measure at issue in the present case does not introduce a difference between the tax treatment of the partners in Columbus, with unlimited tax liability in Germany, who have exercised freedom of establishment, and that of the partners in a permanent establishment located in Germany. However, it does treat cross-border situations differently depending on whether the Member State in which the permanent establishment of the German partners is located applies a level of taxation which is lower or higher than the rate provided for by the AStG. That measure consists in refusal to grant exemption from income tax and tax on capital in Germany, for the purposes of avoiding double taxation, to designated passive income from a permanent establishment located in a Member State where the level of taxation is lower than the rate laid down by the AStG, by applying to such income, still for the purposes of avoiding double taxation, the method of offsetting tax levied abroad.

196. Even accepting, generally, that in a situation involving unilateral replacement of one method for avoiding double taxation by another there may exist an objective of safeguarding the cohesion of the tax system, I none the less wonder in the present case, as the above considerations have indicated, whether that justification is the true objective being pursued by the German authorities in adopting the tax measure at issue. As we have seen, the reason for that measure appears essentially to be the concern to combat tax avoidance by preventing wholly artificial arrangements, or indeed upholding the principle of territoriality.

197. If it is a matter of upholding this principle, as the Federal Republic of Germany claims, it seems to me in particular that it is inconsistent and incompatible with that principle to levy tax on capital on assets derived from a permanent establishment located in another Member State which does not levy such tax and where income tax is lower than the rate applying in Germany, and not to apply that same tax on capital where the assets are derived from an establishment located in a Member State where taxation is higher than in Germany, when that other Member State does not levy tax on capital either.

79 — *Manninen*, cited above, paragraph 46.

198. In those circumstances, I do not think that the tax measure in question can be justified by the concern to preserve the cohesion of the German tax system, as that justification is expressed and interpreted by the Federal Republic of Germany.

199. At the end of my analysis, I consider that Article 52 of the EC Treaty should be interpreted as meaning that it precludes tax legislation of a Member State which, for purposes of avoidance of double taxation, provides for replacement of the exemption method by the set-off method for taxing the income and capital of residents of that State which derive from capital invested in a permanent establishment set up by those residents and located in another Member State where the taxation level is lower than that provided for by the national tax legislation of the first Member State, unless such legislation is justified by the need to prevent wholly artificial arrangements intended to circumvent national legislation. It is for the referring court to determine whether application of the national tax legislation in question in the case in the main proceedings may be justified on that ground.

200. I would add that the conclusion would be the same if the present case were considered from the viewpoint of Article 73b of the EC Treaty.

VI — Conclusion

201. In the light of all the above considerations, I suggest that the Court should answer the question referred by the Finanzgericht Münster as follows:

'Article 52 of the EC Treaty (now, after amendment, Article 43 EC) and Article 73b of the EC Treaty (now Article 56 EC) must be interpreted as meaning that they preclude tax legislation of a Member State which, for the purposes of avoidance of double taxation, provides for the replacement of the exemption method by the set-off method for taxation of the income and capital of residents of that State which derive from capital invested in a permanent establishment set up by those residents and located in another Member State where the level of taxation is lower than that provided for by the national tax legislation of the first Member State, unless such legislation is justified by the need to prevent wholly artificial arrangements designed to circumvent the national legislation. It is for the referring court to determine whether application of the national tax legislation at issue in the main proceedings may be justified on that ground.'