OPINION OF ADVOCATE GENERAL MENGOZZI

delivered on 7 June 2007 [1]

1. By the present reference for a preliminary ruling the Gerechtshof te Amsterdam (Regional Court of Appeal, Amsterdam, the Netherlands) essentially asks the Court to clarify whether national legislation such as the Netherlands legislation, which exempts from withholding tax dividends paid by companies established in the Netherlands to companies established or having a permanent establishment in that State but levies that tax on dividends paid to non-resident companies, is contrary to Articles 56 EC and 58 EC.

I — Legal framework

A — *Relevant Community law*

2. Article 56 EC lays down as follows:

'1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between the Member States and between Member States and third countries shall be prohibited. ...'

3. However, the parts of Article 58 EC that are relevant here provide that:

'1. The provisions of Article 56 shall be without prejudice to the right of Member States:

(a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;

...

1 — Original language: Italian.

3. The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56.'

4. Directive 90/435 exempts from withholding tax the dividends paid by a subsidiary company to its parent company established in another Member State where the latter holds a minimum of 25% of the subsidiary's capital. [2]

B — *National law*

5. Article 1(1) of the 1965 Law on the taxation of dividends (Wet op de dividendbelasting 1965, the 'Wet DB') provides in general for a 25% withholding tax to be levied on dividends distributed by a company established in the Netherlands whose capital is divided wholly or partially into shares.

6. However, the relevant part of Article 4 of the Wet DB provides that:

'Withholding of tax may be waived with respect to the revenue from shares ... if the participation exemption as referred to in Article 13 of the 1969 Law on corporation tax (Wet op de vennootschapsbelasting 1969) is applicable to the proceeds which the beneficiary of the revenue derives from the shares, profit-sharing notes or money loans and the shareholding forms part of the assets of his business carried on in the Netherlands. The first sentence is not applicable to revenue with respect to which the beneficiary is not the final beneficiary'. [3]

7. Furthermore, Article 4a of the Wet DB, which was introduced following the adoption of Directive 90/435, provides for an exemption from dividend tax for shareholders established in the European Union with a minimum shareholding of 25% of the capital of a Netherlands company.

8. That exemption is extended to shareholders established in the European Union with a minimum shareholding of 10% if the

2 — Article 5(1) of 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, in the version in force at the time of the facts in the main proceedings (OJ 1990 L 225, p. 6). That provision was subsequently amended by Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC (OJ 2004 L 7, p. 41).

3 — Unofficial translation.

Member State in which the shareholder is established also applies that exemption on the same percentage shareholding.[4]

9. The abovementioned Article 13 of the 1969 Law on corporation tax (Wet op de vennootschapsbelasting 1969, the 'Wet VB') lays down that, as a general rule, a participation exists where the taxpayer holds at least 5% of the nominal capital of a company whose capital is wholly or partly divided into shares.[5]

C — *The tax convention between the Netherlands and Portugal*

10. Article 10 of the Convention between Portugal and the Netherlands for the Avoidance of Double Taxation and the Prevention of Tax Evasion in respect of Taxes on Income and Wealth, signed at Oporto on 20 September 1999 (the 'DTC'), provides that dividends paid by a company which is resident in one of the Contracting States to a shareholder resident of the other State are, as a rule, taxable in the latter State.

11. Such dividends may, however, be taxed in the State in which the company making the distribution is resident, at a maximum rate of 10% of the gross amount of the dividends.

12. Article 24 of the DTC provides that, in order to avoid double taxation, Portugal allows the tax levied in the Netherlands on dividends from Netherlands sources paid to its residents to be deducted, up to the amount of the Portuguese tax that would otherwise be payable on such dividends.

II — Facts, reference for a preliminary ruling and proceedings before the Court

13. At the time of the events in the case Amurta S.G.P.S., a company with its registered office in Portugal ('Amurta'), held 14% of the capital of Retailbox BV ('Retailbox'), a Netherlands company whose other shareholders were Sonaetelecom BV, another Netherlands company, with 66%, Tafin S.G.P.S and Persin S.G.P.S., both with their registered offices in Portugal, with 14% and 6% respectively.

4 — According to the order for reference, this reduction does not apply to shareholders living in Portugal.

5 — The required participation is reduced to less than 5% where the shareholding forms part of the normal operations of the undertaking managed by the taxpayer or where their acquisition is in the public interest.

14. On 31 December 2002 Retailbox paid its shareholders dividends on which it withheld 25% by way of tax except on the dividends paid to Sonaetelecom BV, on which no withholding tax was levied pursuant to the exemption set out in Article 4 of the Wet DB.

15. On 30 January 2003 Retailbox, on behalf of Amurta, lodged an objection with the Inspecteur van de Belastingdienst Amsterdam (Inspector of the Amsterdam Taxation Office, the 'Inspector') against the withholding tax due on the dividends paid to Amurta. The objection was rejected in a ruling by the Inspector.

16. Amurta appealed to the Gereschtshof te Amsterdam for annulment of that ruling and repayment of the dividend tax withheld.

17. As it had doubts as to the compatibility of the Netherlands legislation in this regard with Articles 56 EC and 58 EC, the referring court decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

'(1) Is the exemption under Article 4 of the [Wet DB] as described in paragraphs [5, 7 and 8] of this judgment, in conjunction with the exemption under Article 4a of that Law, contrary to the provisions on the free movement of capital (Articles 56 EC to 58 EC), given that the exemption is applicable only to dividend payments to shareholders liable to corporation tax in the Netherlands or to foreign shareholders with a permanent establishment in the Netherlands, with the shares forming part of the assets of that permanent establishment, to whom the shareholding exemption under Article 13 of the Wet op de vennootschapsbelasting 1969 [Wet Vpd] applies?

(2) Does the answer to the (preceding) question depend on whether the State of residence of a foreign shareholder/company to which the exemption under Article 4 of the [Wet DB] does not apply grants that shareholder/company full credit for Netherlands dividend tax?'

18. In accordance with Article 23 of the Statute of the Court of Justice, written observations were submitted by Amurta, the Commission, the EFTA Surveillance

Authority and the Netherlands, United Kingdom and Italian Governments. Amurta, the Commission, the EFTA Surveillance Authority and the Netherlands, German and United Kingdom Governments were represented at the hearing.

III — Legal analysis

19. First of all, it must be observed that the legislation in question relates to direct taxes. It should be recalled that, according to settled case-law, although direct taxation falls within the competence of the Member States, exercise of that competence is none the less limited by respect for the principles of Community law, including the fundamental freedoms on which the establishment and the functioning of the internal market are based. [6]

20. In the present case the national legislation in question should be examined in the light of the provisions of the Treaty on the free movement of capital, in that the case relates to provisions on the taxation of dividends paid to companies established in a Member State other than the one in which the company making the distribution is established, in other words, as the Court has stated, operations indissociable from capital movements. [7]

A — *The first question*

21. By its first question, the court of reference asks essentially whether the legislation in question, which applies withholding tax to dividends paid by a Netherlands company to companies not resident in or with a permanent establishment in the Netherlands but not to dividends paid to companies established in that country, is contrary to the free movement of capital. [8]

22. Before broaching the substance of the question to be answered, it is appropriate to make a number of general remarks about the methods for taxing profits distributed by companies. [9]

6 — See, *ex multis*, Case C-35/98 *Staatssecretaris van Financiën* v *Verkooijen* [2000] ECR I-4071, paragraph 32; Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 19; and Case C-471/04 *Keller Holding* [2006] ECR I-2107, paragraph 28.

7 — See, to that effect, the *Verkooijen* judgment, paragraphs 29 and 30.

8 — As the national court correctly notes, given its small shareholding (14%) and the absence of other factors from which it can be deduced that Amurta has powers of decision over the activities of Retailbox, it cannot be considered that freedom of establishment is exercised by means of that shareholding.

9 — With regard to the level of taxation of dividends in the internal market, see in particular the Opinions of Advocate General Geelhoed delivered in Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673; in Case C-513/04 *Kerckhaert and Morres* [2006] ECR I-10967; and in Case C-170/05 *Denkavit Internationaal and Denkavit France* [2006] ECR I-11949.

23. Company profits distributed in the form of dividends are generally taxed at two levels. First, as profits of the company making the distribution in the context of corporation tax, and then at the level of the shareholder. The second level of taxation may take two forms: tax on the income of the shareholder receiving the dividends and/or withholding tax levied by the company making the distribution on behalf of the shareholder at the time when the dividends are paid.

24. The existence of these two possible levels of taxation may lead, on the one hand, to economic double taxation or a series of liabilities to tax (taxation of the same income twice, in the hands of two different taxpayers) and, on the other hand, juridical double taxation (taxation of the same income twice in the hands of the same taxpayer in two different States). Economic double taxation or a series of liabilities to tax occurs when, for example, the profits of the company making the distribution are taxed first in the context of corporation tax, and then in the hands of the shareholder subject to income tax on profits distributed in the form of dividends. Juridical double taxation, by contrast, occurs when a shareholder suffers first withholding tax and then income tax, levied by different States, on the same dividends.

25. In the present case, it should be noted that the Netherlands legislation in question aims to eliminate double taxation of corporate profits distributed in the form of dividends. Article 4 of the Wet DB in conjunction with Article 13 of the Wet VB provides that dividends paid by Netherlands companies to shareholders/companies with a shareholding of at least 5% and their registered office or a permanent establishment in the Netherlands are exempt from the withholding tax of 25%. For companies not established in the Netherlands, exemption from withholding tax on dividends from a Netherlands company applies only where they hold a minimum of 25% of the company's share capital (Article 4a of the Wet DB).

26. It follows that, as regards the taxation of dividends, the legislation treats companies not established in the Netherlands which have a shareholding of between 5% and 25% in a Netherlands company less well than Netherlands companies with the same type of shareholding and which, in contrast to companies not established in the Netherlands, enjoy total exemption from withholding tax on the dividends received.

27. It must therefore be determined whether this difference in treatment

infringes the principle of the free movement of capital. [10]

28. In that regard, it should be recalled that Article 56(1) EC confirms the prohibition on all restrictions on capital movements between Member States — where *restriction* is to be understood to mean any measure that makes the cross-border transfer of capital more difficult or less attractive and is thus liable to deter the investor — unless one of the justifications set out in Article 58 EC applies. [11]

29. In particular, paragraph 1(a) of Article 58 EC permits the Member States 'to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested'.

30. The derogation from Article 56(1) EC, as set out in Article 58(1)(a) EC is, however, limited by Article 58(3) EC, which provides that the measures and procedures referred to in paragraphs 1 and 2 may not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital.

31. Furthermore, by pointing out that the derogations from the free movement of capital provided for in Article 73d(3) of the Treaty (now Article 58(1) EC) had already been recognised in its rulings before that provision had come into force, the Court acknowledged that this provision constituted the legislative codification of a fundamental principle that had been expressed in case-law even before it had been introduced, and equally with reference to other fundamental freedoms. Hence, the provision must also be interpreted in the light of that case-law. [12]

32. It follows that the restrictions on the free movement of capital permitted under Article 58(1)(a) EC are not only limited by the principles codified in Article 58(3) EC but are also subject to the limits established by the case-law of the Court.

10 — As we shall see in greater detail later in the analysis, although it is true that Directive 90/435 (the parent-subsidiary directive) prohibits the levying of withholding tax on dividends paid by a subsidiary to its parent company established in another Member State only if it has a qualifying shareholding (of at least 25% of the subsidiary's capital), it cannot nevertheless be deduced from that fact, as suggested by the referring court and supported by the Netherlands Government, that the contrary holds true, in other words that a levy is permitted in all other cases, with the consequence that any difference in treatment in relations between parent and subsidiary companies established in different Member States should be attributed solely to the coexistence of different tax regimes. Although it is true that it is for the Member States to determine whether and to what extent double taxation should be eliminated on shareholdings that fall outside the scope of the above directive, in the exercise of that competence they are none the less required to comply with the principles of Community law, which include the fundamental freedoms.

11 — Case C-222/97 *Trummer and Mayer* [1999] ECR I-1661, paragraph 26.

12 — See the *Verkooijen* judgment, paragraph 43.

33. With regard to national tax legislation such as that at issue, which makes a distinction in the taxation of dividends on the basis of the residence of the shareholder receiving them, the Court has stated that for such tax systems to be regarded as compatible with the Treaty provisions on the free movement of capital, the difference in treatment must concern situations which are not objectively comparable or be justified by overriding reasons in the general interest, and it must not go beyond what is necessary in order to attain the objective of the legislation. [13]

The comparability of the situation

34. As noted above, the national provisions at issue treat dividends distributed by Netherlands companies differently, depending on whether they are paid to resident companies or to companies not resident in the Netherlands. [14]

35. Where direct taxes are concerned, the Court has stated that a difference in treatment based on the place of residence is not in itself discriminatory, since as a general principle that criterion is indicative of the taxpayer's link with his country of origin and may therefore justify differentiation in tax treatment. [15]

36. However, the Court has explained that, in the case of a tax advantage denied to non-residents, a difference in treatment between the two categories of taxpayer might constitute discrimination within the meaning of the Treaty where there is no objective difference in situation such as to justify different treatment on this point as between the two categories of taxpayers. [16]

37. According to the reasoning of the Court, there could be discrimination between residents and non-residents if, notwithstanding their residence in different Member States, it was established that, having regard to the purpose and content of the national provisions in question, the two categories of taxpayers are in a comparable situation. [17]

13 — See Case C-315/02 *Lenz* [2004] ECR I-7063, paragraph 27 and the case-law cited.

14 — On the basis of the Netherlands legislation in question, in fact, companies that are not established in the Netherlands can enjoy the same advantages in the taxation of dividends as companies established there only if they have a permanent establishment in the Netherlands to which the shares in Netherlands companies belong.

15 — See Case C-279/93 *Schumacker* [1995] ECR I-225, paragraphs 31 to 34; Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 18; Case C-107/94 *Asscher* [1996] ECR I-3089, paragraph 41; and Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, paragraph 27.

16 — See the judgments cited above in *Schumacker*, paragraphs 36 to 38; *Asscher*, paragraph 42; and *Royal Bank of Scotland*, paragraph 27 et seq.

17 — Judgment in Case C-391/97 *Gschwind* [1999] ECR I-5451, paragraph 26.

38. It must therefore be established whether, *having regard to the function of the contested legislation*, there is an objective difference of treatment between the situation of shareholder companies receiving dividends distributed by a Netherlands company in which they hold shares according to whether they are resident or non-resident in the Netherlands.

39. It should be noted that the purpose of the provisions at issue is to eliminate the imposition of a series of liabilities to tax on profits distributed by Netherlands companies.

40. In that regard, the Court has stated that, in the context of measures laid down by a Member State in order to prevent or mitigate the imposition of a series of liabilities to tax on, or the double taxation of, profits distributed by a resident company, resident shareholders receiving dividends are not necessarily in a situation which is comparable to that of shareholders receiving dividends who are resident in another Member State. [18]

41. Indeed, as the Court has found, the Member State in which the company making the distribution is resident generally acts, in relation to a non-resident shareholder, as the 'source State', exercising its power of taxation only with regard to the non-resident's income earned on the territory of that State. To require that State to ensure that profits distributed to a non-resident shareholder are not liable to a series of liabilities to tax or to economic double taxation would mean that that State would be obliged to abandon its right to tax a profit generated through an economic activity undertaken on its territory. [19] On the contrary, it is usually the Member State in which the shareholder is resident that is best placed to grant the latter a tax advantage capable of preventing or mitigating a series of liabilities to tax or economic double taxation. Indeed, in the case of a shareholder who is a physical person, it is the State in which he is resident that is best able to determine the shareholder's ability to pay tax. [20] As regards dividends received by a company, Article 4(1) of Directive 90/435 requires the Member State of the parent company which receives profits distributed by a subsidiary established in another Member State, and not the latter State, to avoid double taxation, and does so by allowing the State of the parent company to choose between refraining from taxing such profits or taxing them while authorising the parent company to deduct from the amount of its own tax that fraction of the tax paid by the subsidiary on those profits and, if appropriate, the amount of the withholding tax levied by the Member State in which the subsidiary is resident. [21]

42. However, the Court has stated that 'once a Member State, unilaterally or by a conven-

18 — See the judgments in *Denkavit Internationaal and Denkavit France*, paragraph 34, and in *Test Claimants in Class IV of the ACT Group Litigation*, paragraphs 57 to 65.

19 — *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 59.

20 — This principle is confirmed in *Schumacker*.

21 — *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 60.

tion, imposes a charge to income tax not only on resident shareholders but also on non-resident shareholders in respect of dividends which they receive from a resident company, the position of those non-resident shareholders becomes comparable to that of resident shareholders'. [22]

43. In that case, though exercising its own jurisdiction as 'source State', the State in which the company making the distribution is established exercises a power of taxation in relation to non-resident shareholders that is no different from that exercised in relation to residents, causing imposition of a series of liabilities to tax on both categories of taxpayer in the exclusive exercise of its fiscal jurisdiction.

44. Where the situation of resident and non-resident shareholders is comparable, the 'source State' will be required to extend to non-residents tax benefits equivalent to those granted to residents if, as a result of the exercise of its power of taxation, non-residents are liable to a series of liabilities to tax comparable to that affecting residents.

45. Hence, if, as in the present case, the 'source State' decides to save its own residents from domestic double taxation by exempting them from withholding tax on dividends received from a Netherlands company, that State must extend that exemption to non-residents since they suffer the same domestic double taxation as a result of the exercise of its power of taxation over them.

46. From the analysis so far, it follows that the provisions at issue constitute arbitrary discrimination contrary to Articles 56 EC and 58 EC, since they deny exemption from withholding tax on dividends paid to shareholders who are not resident in the Netherlands while allowing that exemption for dividends received by resident shareholders. [23]

47. However, the Italian and United Kingdom Governments hold that the difference in treatment under the disputed legislation to the detriment of non-residents is merely a consequence of the allocation of powers of taxation between the Netherlands and Portugal.

22 — Ibid., paragraphs 68 to 70.

23 — The EFTA Court reached a similar decision in the judgment of 23 November 2004 in Case E-1/04 *Fokus Bank*, in which it held that Norwegian legislation that granted a tax credit on dividends paid in Norway only to shareholders resident in that country was contrary to Article 40 of the EEA Agreement, equivalent to Article 56 EC (Agreement on the European Economic Area; OJ 1994 L 1, p. 3).

48. A number of clarifications are necessary in that regard.

49. By virtue of the second indent of Article 220 of the EC Treaty (now the second indent of Article 293 EC), 'Member States are required, so far as necessary, to 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'.

50. That provision, which lays down a programme for the Member States, has not yet been implemented. In its current state, Community law does not lay down any general criteria for the allocation of areas of competence between the Member States in relation to the elimination of double taxation within the Community. 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, [24] Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises [25] and Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, [26] none of which is applicable in the present case, no uniform or harmonisation measure designed to eliminate double taxation has as yet been adopted at Community law level, nor have the Member States concluded any multilateral convention to that effect under the second indent of Article 220 of the EC Treaty. [27]

51. It follows that in the absence of unifying or harmonising Community measures the Member States remain competent to determine the criteria for taxation of income with a view to eliminating double taxation, where appropriate by means of conventions. [28] In that context, the Court stated initially that the Member States were at liberty, in the framework of bilateral agreements, to determine the connecting factors for the purposes of allocating powers of taxation. [29] In subsequent rulings it added that that freedom accorded to the Member States also extended to measures adopted unilaterally. [30]

24 — Cited above in footnote 2.

25 — OJ 1990 L 225, p. 10.

26 — OJ 2003 L 157, p. 38.

27 — See, in particular, with regard to the free movement of capital, the judgment in *Kerckhaert and Morres*, paragraph 22, and with regard to Article 52 of the EC Treaty, the judgment in *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 51.

28 — Judgments in Case C-336/96 *Gilly* [1998] ECR I-2793, paragraphs 24 and 30, and in 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), in Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 57, as regards Articles 52 and 58 of the EC Treaty, and in Case C-513/03 *van Hilten-van der Heijden* [2006] ECR I-1957, paragraph 47, as regards the free movement of capital.

29 — Judgments in *Gilly*, paragraphs 24 to 30; *Saint-Gobain ZN*, paragraph 57; *de Groot*, paragraph 93; Case C-290/04 *FKP Scorpio Konzertproduktionen* [2006] ECR I-9461, paragraph 54; and *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 52.

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

52. However, as far as the exercise of the power of taxation is concerned, the Member States must comply with the Community rules.[31]

53. According to the case-law of the Court, the Member States are therefore at liberty to decide whether and to what extent, either unilaterally or by means of international agreements, they eliminate or prevent double taxation, but they must none the less comply with the Community principles in the exercise of their power of taxation, even when the latter is the result of a bilateral or multilateral prior allocation of fiscal competence among the Member States.[32]

54. In the case at issue, it is clear that the discrimination under the Netherlands legislation on the taxation of dividends paid to non-resident companies is not the result of differences between the national fiscal systems involved in the case, and even less the effect of the allocation of powers of taxation between the Netherlands and Portugal. Instead, as pointed out above, it is discriminatory treatment attributable *solely* to the Netherlands legislation in question, which denies to non-resident shareholders a tax advantage enjoyed by residents, without that difference in treatment being justified by relevant objective factors, given that the situation of the two categories of taxpayer has been found to be comparable as far as the object and functioning of the provisions at issue are concerned.

55. Nevertheless, when we come to examine the second question we shall see the impact that appropriate allocation of powers of taxation by means of a double taxation convention may have in neutralising the discriminatory effects of national provisions such as the Netherlands legislation in question.

56. In the alternative, the Netherlands and Italian Governments maintain that the legislation under examination is justified by the need to preserve the cohesion of the Netherlands tax system. They claim that the exemption from withholding tax on domestic dividends distributed by Netherlands companies to companies resident in the Netherlands is a fundamental complement to the exemption of shareholdings from corporation tax ('shareholding exemption', Article 13 of the Wet VB) enjoyed by Netherlands companies subject without limitation to taxation in the Netherlands, which are not taxed, in the framework of that tax, on share dividends. In particular, according to those governments, that exemption is a necessary complement to the exclusion of distributed profits from the tax base for

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

32 — *De Groot*, paragraphs 93 to 94.

Netherlands corporation tax and merely implements an administrative simplification, in that it prevents the need for dividends tax withheld at source to be subsequently returned to the recipients of dividends who enjoy the 'shareholding exemption' in the Netherlands when they are assessed for corporation tax. Such an administrative simplification could therefore not, in the view of the Netherlands and Italian Governments, be extended to shareholders who are not resident in the Netherlands and who are not subject to Netherlands corporation tax.

57. That argument cannot be accepted.

58. As regards the need to safeguard the cohesion of the national tax system, it should be recalled first of all that this has been a settled concept of case-law since the judgments in *Bachmann* v *Belgium* and *Commission* v *Belgium*, in which the Court recognised as a general rule that that requirement was an overriding reason of public interest likely to justify a restriction on the fundamental principles of the freedom of movement.[33]

59. In those cases the Court cited the cohesion of the tax system as justification for national legislation that made the deductibility of pension and life assurance contributions subject to the condition that they were paid in the Member State permitting such deduction. That restriction was justified by the need to offset the loss of revenue resulting from the deduction of contributions paid under insurance contracts with the taxation of the sums received under such contracts, which could not, however, be taxed in the case of insurance companies established abroad.

60. Since these rulings, the need to safeguard the cohesion of the tax system has been the justification most frequently invoked by the Member States with regard to direct taxes. However, the Court has greatly narrowed the concept of fiscal cohesion, and in settled case-law it has acknowledged that that need justifies a measure restricting the fundamental freedoms if three distinct conditions are met: (a) there is a direct link between the grant of a tax advantage and the offsetting of that advantage by a fiscal levy; (b) the deduction and the levy both relate to the same tax; and (c) they are applied to one and the same taxpayer.

61. In the present case, strict application of this case-law would lead the Court, prima facie, to disallow the justification based on the cohesion of the tax system, in that the exemption from dividends tax and the exemption of shareholdings from corpora-

33 — Case C-204/90 *Bachmann* v *Belgium* [1992] ECR I-249, paragraphs 21 to 28, and Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305, paragraphs 14 to 21.

tion tax, which the Netherlands and Italian Governments consider to be complementary and thus need to be applied together in order to ensure the cohesion of the Netherlands tax system, relate to two separate taxes and in formal terms do not involve the same taxpayer.

62. However, in the *Manninen* judgment the Court appears to have attenuated the rigid interpretation of the concept of cohesion of the tax system based on the criteria of 'the same tax' and 'one and the same taxpayer' by acknowledging, in line with the proposals made by Advocate General Kokott in her Opinion in that case, that a Member State may rely upon the need to safeguard the cohesion of its tax system, even though in the case in point the two abovementioned criteria could not be applied. [34]

63. Referring to the abovementioned case-law of the Court, the Netherlands Government considers that in the present case there are two related exemptions, one of which constitutes an extension of the other, and that although formally they relate to two separate taxes (dividends tax and corporation tax), from the substantive point of view they involve a single fiscal levy, in that withholding tax on dividends paid out is, in the view of the Netherlands Government, simply an advance of tax to be offset fully against corporation tax and in fact falls on the same taxpayer (the shareholder in receipt of the dividends).

64. Even if it were accepted that the two exemptions in question relate in substance to the same taxpayer and the same fiscal levy, it must be ascertained that there is an actual need to preserve the cohesion of the Netherlands tax system in the light of the objectives of the contested legislation.

65. As the Netherlands and Italian Governments maintain, exemption from withholding tax on the domestic dividends would appear to be necessary to preserve the cohesion of the Netherlands tax system, because without it the related exemption of shareholdings from corporation tax would be jeopardised — albeit temporarily — until the dividends tax were offset against corporation tax. It is clear that the Netherlands system, illustrated in these terms, is intended to achieve a 'mere administrative simplification', which of itself could not in any event justify discriminatory treatment contrary to the fundamental freedoms.

66. The Netherlands Government does not show, however, how the cohesion of its tax

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

system would be compromised if exemption from dividends tax were also granted to non-resident shareholders who, although not liable to corporation tax in the Netherlands, are, as we have seen above, in a situation comparable to that of residents as regards the taxation of dividends and any tax advantages associated with the elimination of double taxation. On the other hand, it is clear that the object of the disputed legislation, that is to say the avoidance of a series of liabilities to tax on profits distributed in the form of dividends, may also be achieved without it being necessary to discriminate against non-resident shareholders by granting them the exemption from withholding tax that is accorded to resident shareholders, without in any way compromising the cohesion of the Netherlands tax system.

67. It is clear from the above that the arguments put forward by the intervening governments cannot justify the restriction on capital movements deriving from the tax system in question.

68. The answer to the first question must therefore be that the provisions on the free movement of capital preclude national legislation — considered without taking account of the effects of any double taxation conventions that may be applicable — that exempts dividends paid by a Netherlands company to companies established in the Netherlands from withholding tax but makes dividends paid to companies that have neither their seat in that State nor have a permanent establishment there subject to such a tax.

B — *The second question*

69. By its second question the court of reference asks essentially whether, in assessing the compatibility of the Netherlands legislation at issue with the principles of Community law on the free movement of capital, it is relevant that a company not established in the Netherlands or which does not have a permanent establishment there can deduct in full in its country of residence the withholding tax charged in the Netherlands on dividends distributed by a Netherlands company.

70. It must be observed from the outset that the court of reference does not specify the provisions under which a company such as Amurta could enjoy, in its country of residence (Portugal), a full tax credit to offset the withholding tax levied in the Netherlands.

71. I shall therefore first analyse the extent to which the granting of a full tax credit to a non-resident shareholder under national

legislation in his country of residence may be of relevance in assessing the Netherlands legislation, and I shall then consider the possibility that such a tax credit may be recognised under the DTC between the Netherlands and Portugal.

1. The relevance of a full tax credit provided for by the national legislation of the country of residence of the taxpayer concerned

72. In my opinion, in mentioning the existence of a possible full tax credit to offset the Netherlands withholding tax on the dividends received by Amurta, the national court was referring in general terms to the possible concession that Amurta might presumably enjoy under Portuguese legislation. In the relevant passage of the order for reference, the national court points out that, on the basis of the information in Amurta's observations, in Portugal there is a provision similar to the Netherlands provision for the reimbursement of withholding tax on dividends if corporation tax is not payable on such income (the full tax credit system). The national court deduces from that fact that, in the present case, the Netherlands withholding tax would probably be offset in Portugal under the above-mentioned full tax credit mechanism.

73. In the present proceedings, however, Amurta has denied that there exists a potential full tax credit, such as that described by the referring court in the order, that Amurta could claim in Portugal to offset the withholding tax levied in the Netherlands on the dividends it received there. According to Amurta, Portugal also has a system of 'participation exemption' similar to the one applied in the Netherlands, under which income from shareholdings is exempt from corporation tax. Consequently, no offsetting between withholding tax on dividends paid in the Netherlands and corporation tax in Portugal was possible, since no sum was payable in Portugal in that respect.

74. If the reconstruction carried out by Amurta is considered correct, and given the incomplete nature of the order for reference from which no further useful information can be deduced on this point, the second question submitted to the Court would be purely hypothetical.

75. In that case, the Court would not have jurisdiction to answer that question, since, according to settled case-law, 'the justification for a preliminary reference, and hence for the jurisdiction of the Court, is not that it enables advisory opinions on general or hypothetical questions to be delivered ... but rather that it is necessary for the effective resolution of a dispute'. [35]

35 — See *Lenz*, paragraph 52, and the case-law cited.

76. Should the Court nevertheless decide that it is appropriate to rule on the second question from the referring court, in my opinion it should reply as follows.

77. I do not consider that any relevance can be attached to a tax advantage based on the domestic legislation of a Member State, however large or effective that advantage may be, for the purpose of assessing the compatibility of the legislation of another Member State with the principles of Community law.

78. In my opinion, it cannot be held that, in a case such as that before the Court, the discriminatory effects of national legislation on a taxpayer can be neutralised by benefits granted to him under the legislation of another Member State. To accept the contrary would, in essence, be tantamount to allowing a Member State to avoid its obligations under Community law by making compliance dependent on the possible effects of the national legislation of another Member State, which may be amended unilaterally at any time by that State. In such a situation there would be no legal certainty that a Member State would comply with the prohibition on arbitrary discrimination laid down in Articles 56 EC and 58 EC.[36]

79. From the observations made so far, it follows that for the purposes of assessing the compatibility of the Netherlands legislation on the taxation of dividends no relevance can be attached to the fact that a company such as Amurta receives a full tax credit in its country of residence, under the legislation in force in that country, that may offset the Netherlands withholding tax on the dividends received by that company in the Netherlands.

2. The relevance of double taxation conventions and actual effects of the applicable DTC

80. In my opinion, one arrives at a different answer to that set out in the preceding paragraph where neutralisation of the discriminatory effects of national legislation is

36 — Moreover, the Court has systematically rejected the argument that detrimental tax treatment contrary to a fundamental freedom can be justified by the existence of other tax advantages, even if those advantages exist. As regards national tax treatment examined with respect to: (a) the free movement of workers, see the judgment in *de Groot*, paragraph 97; (b) the freedom of establishment, see the judgments in Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 21, in *Asscher*, paragraph 53, and in *Saint-Gobain ZN*, paragraph 54; and (c) the free movement of capital, see the judgment in *Verkooijen*, paragraph 61.

achieved by appropriate allocation of the power of taxation between Member States by means of an international double taxation convention. This stems from the fact that the taking into account of the actual effects of a DTC on a taxpayer's situation in order to ascertain whether in an individual case there is a restriction on the freedoms of movement guaranteed by the Treaty does not justify the discriminatory disadvantage that the taxpayer concerned suffers as a result of the application of national legislation, and of the subsequent offsetting of that disadvantage by an uncertain advantage that has no connection with the former and is based on the legislation of another Member State that the latter may amend at any time. By contrast, attaching relevance to the actual effects of a DTC on a taxpayer's situation makes it possible, first of all, to take into account 'the economic reality of that taxable subject's activity and incentives in a cross-border context', [37] but also, and above all, to take account of the way in which the Member States have complied with the fundamental freedoms by means of appropriate allocation of their power of taxation by assuming *reciprocal commitments based on a binding act*. This avoids creating legal uncertainty as to the Member States' compliance with their Community obligations while according due relevance to their power, in the absence of harmonisation at Community level, to establish as they see fit the criteria for allocating fiscal jurisdiction with a view to eliminating double taxation.

81. This is possible if two fundamental conditions are met. First, it must be ascertained that in the particular case the overall treatment of a taxpayer under the relevant provisions of a DTC complies in *concrete* terms with the Community principles regarding freedom of movement. In a situation such as that under examination, for example, the 'source State' could ensure, by means of a DTC, that resident and non-resident taxpayers in a comparable situation enjoy the same benefits as regards the elimination of double taxation. Secondly, the State whose legislation is in itself contrary to Community principles must continue to be under a duty to neutralise such distorting effects of its legislation, without being able to escape its obligations under the Treaty by citing the failure of the other contracting party to take the measures provided for in the DTC. [38]

82. The Court reached a similar conclusion as to the relevance to be attached to DTCs when it found that the provisions of a DTC must be taken into account in order to give an interpretation of Community law that is relevant to the national court if the latter has

37 — See points 33 to 38 of the Opinion of Advocate General Geelhoed in *Denkavit Internationaal and Denkavit France* and my Opinion in Case C-298/05 *Columbus Container*, point 47.

38 — To that effect, see points 39 to 43 of the Opinion in *Denkavit Internationaal and Denkavit France*.

presented the convention as forming part of the legal background to the main proceedings.[39]

83. As we have seen above, in the present case the referring court asks the Court to rule on the relevance of a 'full tax credit' to which Amurta would presumably be entitled in Portugal, but without clarifying whether that possibility flows from application of the relevant DTC between Portugal and the Netherlands.

84. The Netherlands, Italian and United Kingdom Governments consider that the Court should take account of that DTC in assessing the compatibility of the disputed Netherlands legislation with the principles on the free movement of capital.

85. In my view, as I have already explained, nothing is discernible in the order for reference from which it can be deduced that the national court intended to refer to the relevant provisions of the DTC between Portugal and Netherlands; in contrast, it appears that that court merely referred in general terms to the national Portuguese legislation in indicating the possibility of a 'full tax credit'.[40]

86. For the purposes of assessing the compatibility of the Netherlands legislation at issue, I shall therefore examine the concrete effects of the relevant DTC only in the alternative in the event the Court considers that the national court was referring to that DTC in mentioning the existence of a 'full tax credit' and that the DTC therefore forms part of the legal background on which the Court is called upon to rule.

87. In order to neutralise the effects of the Netherlands legislation in question, which, as found above, discriminates against non-residents, the relevant DTC would have to provide for an allocation of the power of taxation between the contracting parties that eliminated the disadvantage suffered by non-residents with regard to withholding tax levied on them in the Netherlands. This would be possible only if the effects of the withholding tax were entirely eliminated in Portugal, in other words by means of the full offsetting of the Netherlands withholding tax

39 — See the judgments in *Manninen*, paragraph 21; Case C-265/04 *Bouanich* [2006] ECR I-923, paragraph 51; *Test Claimants in Class IV of the Act Group Litigation*, paragraph 71; and *Denkavit Internationaal and Denkavit France*, paragraph 45.

40 — The position also maintained by the EFTA Surveillance Authority.

on dividends against corporation tax otherwise payable in Portugal on those dividends. Technically, this would be a 'full tax credit' that the country of residence of the taxpayer concerned (Portugal) would grant to offset the withholding tax on dividends charged by the 'source State' (the Netherlands). [41]

88. Article 24 of the DTC in question provides, instead, for a system of ordinary or partial tax credit, in other words it allows the taxpayer to deduct the Netherlands withholding tax on dividends up to the amount that would otherwise be payable in Portugal, by way of corporation tax, on the profits received in the form of foreign dividends. [42] In that case, a Portuguese company such as Amurta would continue to bear part of the effects of Netherlands withholding tax, in contrast to the provisions of the Netherlands legislation for a company resident in that country, which is completely exempt from double taxation of dividends received in the Netherlands. Hence, the benefits granted to companies not established in the Netherlands would not be equivalent to those granted to resident companies in a comparable situation as regards the effects of double taxation of income from shareholdings in Netherlands companies, with the consequence that the Netherlands legislation in question would continue to lead to arbitrary discrimination prohibited by Articles 56 EC and 58 EC.

89. However, if it were found that Portugal operated a system of 'participation exemption', under which income from shareholdings are exempt from corporation tax, the fact that the relevant DTC provides for a full tax credit would be of no actual benefit to Amurta, since as I have already observed no tax would be payable in Portugal on income from shareholdings against which it could offset the Netherlands withholding tax on the distributed dividends.

90. However, as the Court has stated, it is for the national court to interpret the relevant national law and hence to ascertain whether, in the case in point, the overall treatment of a non-resident company on the basis of the joint exercise of the power of taxation, as apportioned by convention between the 'source State' and the State of residence, is not less favourable than that accorded to resident companies. [43]

41 — A similar solution was reached in *Denkavit Internationaal and Denkavit France*, paragraphs 54 to 56.

42 — Under the partial tax credit mechanism, neutralisation of the effects of Netherlands withholding tax would be possible only if the same tax rate were applied in the Netherlands and Portugal, so that the amount of Netherlands withholding tax were the same as the amount of Portuguese corporation tax applicable to Netherlands dividends and could therefore be completely offset by the latter.

43 — See, to that effect, *Bouanich*, paragraph 51.

IV — Conclusions

91. In the light of the considerations set out above, I propose that the Court reply as follows to the questions submitted for a preliminary ruling by the Gerechtshof te Amsterdam:

'(1) Articles 56 EC and 58 EC preclude national legislation such as that at issue in the main proceedings — considered without taking account of the effects of any double taxation conventions that may be applicable — that exempts dividends paid by companies with their seat in the Netherlands to companies with their seat in that State from withholding tax but makes dividends paid to companies that have neither their seat nor a permanent establishment in that State subject to such a tax.

(2) For the purposes of the reply to the first question, it is irrelevant that a company which has neither its seat nor a permanent establishment in the Netherlands may in its own country of residence under the legislation of that country claim a full tax credit to offset the Netherlands withholding tax on dividends, even if such a possibility exists.