OPINION OF ADVOCATE GENERAL GEELHOED
delivered on 27 January 2005 [1]

I — Introduction

1. The issue raised by the present case is whether a German citizen living in Germany may invoke Articles 12 and 18(1) EC in order to be permitted to deduct as special expenses from his income tax declaration maintenance payments paid to his divorced spouse who is resident in Austria.

II — Relevant provisions

A — *Community law*

2. Article 12 EC prohibits any discrimination on grounds of nationality within the scope of application of the EC Treaty.

3. Article 17 EC establishes citizenship of the Union and accords this status to every person holding the nationality of a Member State. Citizens of the Union enjoy the rights conferred by the EC Treaty and are subject to the duties it imposes.

4. Article 18(1) EC guarantees the right of every citizen to move and reside freely within the territory of the Member States, subject to the limitations and conditions laid down in the Treaty and by the measures adopted to give it effect.

B — *German law*

5. Paragraph 10(1), point 1, of the Einkommensteuergesetz (Income Tax Law, hereinafter: EStG) provides that maintenance payments to a divorced spouse, who is wholly liable to income tax, may be deducted in respect of the assessment periods from 1994 to 1997 up to a maximum of DEM 27 000 at the request of the payer and with the consent of the recipient. Paragraph 22(1a) EStG provides that payments deductible by the payer under Paragraph 10(1), point 1, EStG

1 — Original language: English.

constitute taxable income in the hands of the recipient of the maintenance (under the so-called principle of correspondence). It is not necessary, for maintenance payments to be deductible, that the inclusion of maintenance payments for tax purposes actually results in taxation of the recipient thereon. If the recipient of the maintenance payments must declare the payments for tax, the person making such payments is liable, as a matter of civil law, to pay the income tax due thereon. Under Paragraph 1a(1), point 1, EStG, maintenance payments to a divorced spouse may also be deducted where the recipient is not wholly liable to income tax, but has his or her place of residence (or habitual abode) in another Member State of the European Union. As regards Austria this rule is applicable with effect from the assessment period 1994. However, this facility is only available if the competent foreign tax authority has certified that the maintenance payments received by the former spouse have been taxed.

III — Facts, procedure and preliminary questions

6. Mr Schempp, a German citizen living in Germany, makes maintenance payments to his divorced spouse, who is resident in Austria. In his income tax declarations for the years 1994 to 1997, he sought to deduct these payments as special expenditure under Paragraph 10(1), point 1, EStG in conjunction with Paragraph 1a(1), point 1, EStG to the amount of DEM 8 760 for the years 1994, 1995 and 1997 and DEM 10 230 for the year 1996 under the de facto joint taxation regime (*Realsplitting*). However, the Finanzamt took no account of these maintenance payments in the income tax assessment notices for the years 1994 to 1997 as Mr Schempp had failed to produce a certificate issued by the Austrian tax authorities, testifying that the payments had indeed been taxed in Austria. In fact, Mr Schempp did not or could not produce such certification, because under Austrian income tax law maintenance payments are in principle not subject to taxation, nor is deduction of maintenance payments provided for. It appears from the case file, that if his former wife had been resident in Germany, Mr Schempp would have been able to deduct the total sum of the maintenance payments. Moreover, the spouse would not have had to declare them, as her income is less than the taxable minimum (subsistence level).

7. Mr Schempp lodged objections against the Finanzamt's assessment notices on the grounds that the relevant provisions of the EStG were contrary to Articles 12 and 18(1) EC. These objections were rejected by the Finanzamt by decision of 27 July 1999. After the action he subsequently brought against this decision had been dismissed by the Finanzgericht, he appealed to the Bundesfinanzhof (Revision). Considering that it was not clear how Articles 12 and 18 EC ought to be construed in relation to the application of the relevant provisions of the EStG, the Bundesfinanzhof decided to stay the proceedings and refer the following two pre-

liminary questions to the Court under Article 234 EC:

'1. Is Article 12 of the EC Treaty (as amended by the Treaty of Amsterdam) to be interpreted as meaning that Paragraph 1a(1), point 1, and Paragraph 10(1), point 1, of the Einkommensteuergesetz, to the effect that a taxpayer resident in Germany is not entitled to deduct maintenance payments to his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany, are incompatible therewith?

2. If Question 1 is answered in the negative: is Article 18(1) EC to be interpreted as meaning that Paragraph 1a(1), point 1, and Paragraph 10(1), point 1, of the Einkommensteuergesetz, to the effect that a taxpayer resident in Germany is not entitled to deduct maintenance payments for his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany, are incompatible therewith?'

8. Written observations were submitted by Mr Schempp, the German and Netherlands Governments and the Commission.

IV — Assessment

9. It must first be observed that the preliminary questions are aimed at ascertaining whether or not two provisions of the EStG must be considered to be compatible with Articles 12 and 18 EC. Although the Court is unable to give a direct answer to the questions drafted in this manner, it can answer the question as to whether national provisions of this type may be deemed to be compatible with the Treaty provisions concerned.

A — *The first question*

10. By its first preliminary question the Bundesfinanzhof asks whether it is contrary to Article 12 EC for a Member State to refuse a taxpayer entitlement to deduct maintenance payments to his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany.

1. The scope of Article 12 EC

11. The prohibition of discrimination on grounds of nationality contained in Article 12

EC can only be invoked in respect of situations which fall within the scope of the EC Treaty. Given that Mr Schempp, as the interested party, lives and works in Germany and is confronted with a problem concerning his income tax in Germany, the only cross-border element being that he makes maintenance payments to his former spouse in Austria, it may be queried whether there is a sufficient link between his situation and Community law.

12. On this point, and referring to the Court's judgment in *Saint Gobain*, Mr Schempp observes that it appears from the Court's caselaw that subjecting a national taxpayer who has made certain transfers to a non-resident, to a higher tax rate in Germany for the sole reason that the beneficiary is a foreign national and not German, amounts to indirect discrimination. [2] The Commission considers that, although he himself has not used the right to move to another Member State, Mr Schempp may nevertheless invoke Article 12 EC in conjunction with Article 18(1) EC. As a divorced couple is considered to be a fiscal unit according to the principle of correspondence in German tax law, it maintains that the fact that Mr Schempp's former spouse has made use of her right to move may be imputed to him.

13. On the other hand, the German and Netherlands Governments emphasise that the application of the principle of non-discrimination presupposes that there is a connection between the circumstances of the case and the freedom of movement guaranteed by the EC Treaty. As it is not Mr Schempp, but his former wife, who made use of her right to move to another Member State, he is not in a position to invoke Article 12 EC. The situation, in their view, is purely internal to Germany. The Netherlands Government, in this respect, draws a parallel with the *Werner* case in which the Court held that the fact that a person who conducted all his economic activities in a Member State of which he was a national was resident in another Member State did not preclude the first Member State from imposing a heavier tax burden on him. [3]

14. At first sight, there appear to be a number of reasons for considering that the problem raised by the present case does not fall within the scope ratione materiae of Community law. Firstly, most of the relevant facts relating to Mr Schempp's situation are concentrated on German territory, suggesting that this is indeed an internal situation to which Community law does not apply. Secondly, the link to the right to move freely to another Member State is extremely tenuous, as it is not Mr Schempp, but his former wife, who has exercised her right to move under Article 18(1) EC. Moreover, the relevant provisions of the EStG do not seem to impose any obstacle to the exercise of this right. On the contrary, although the money

2 — Case C-307/97 *Saint Gobain* [1999] ECR I-6161.

3 — Case C-112/91 *Werner* [1993] ECR I-429.

received by the former spouse remains below the threshold for taxation in Germany, if it were not, it would be more attractive for the recipient to move to Austria where the maintenance allowance is exonerated from taxation. Establishing a link with Article 18 (1) EC is, therefore, artificial.

15. However, I do not believe that these factors necessarily lead to the conclusion that the present case must be regarded as being an internal situation falling outside the ambit of Community law. More generally, it must be realised that qualifying a given set of facts and circumstances as an internal situation implies that the conformity with Community law of the legal provisions which govern them, in effect, is excluded from being subject to judicial scrutiny. This is particularly relevant where the Member States must increasingly take account of cross-border circumstances in their legislation as a result of citizens exercising their rights to move freely within the European Union. The concept of the internal situation, should therefore, in my view, only be applied in the most evident of cases. As it is undeniable that in this case a cross-border element is involved which significantly affects Mr Schempp's tax situation, it cannot be regarded as being purely internal to Germany.

16. I would add to this that, following this approach, a case such as *Werner*, which predated the introduction of the Treaty provisions on citizenship, currently would not be excluded from consideration under Community law for the sole reason that the taxpayer involved did not reside in the Member State where he worked and paid his taxes.

17. That being said, the question which arises is: which link exists between the facts underlying the present case and Community law if it is not to be found in the exercise by Mr Schempp of his citizenship rights under Article 18(1) EC? The Commission's suggestion that the connection is to be found in the fact that, as Mr Schempp and his former wife are to be regarded as a fiscal unit under German tax law, the exercise of the right to move by the one partner may be attributed to the other is, in my view, not convincing. The applicability of Community law cannot depend on such concepts used in national law, but must be determined on the basis of the concrete circumstances of the case at hand.

18. The main cross-border aspect involved in this case is to be found in the payments made by Mr Schempp to his former spouse in meeting his maintenance obligations under civil law. Such payments may not be subject to any restriction as is laid down in Article 56 EC. Although no such restriction is involved in the present case and indeed has not been invoked, this is where the substantive link with Community law lies. By way of illustration, I would refer to the hypothetical situation that the EStG, instead of making deductibility conditional on the payments being taxed in the Member State of residence of the recipient, may well have

provided that deductibility was excluded in case the maintenance allowance was paid to a former spouse outside Germany. That would have constituted a clear restriction to the freedom of payments guaranteed by Article 56 EC. As the relevant provisions of the EStG regulate the same aspect, though in a different manner, they must by their nature fall within the scope of this same Treaty provision. In this context I would refer further to Article 58(1)(a) EC which contains a general exception in respect of the application of national tax law, permitting Member States, within the limits set by Article 58(3) EC, to distinguish between taxpayers who are not in the same situation with regard to their place of residence. I do not suggest that the EStG indeed imposes any kind of restriction on the payments made by Mr Schempp. Legislation of this type may, however, potentially affect such payments and therefore comes within the scope ratione materiae of the Treaty.

19. In addition, Mr Schempp's rights and obligations under national tax law are affected by the fact that, for the purposes of calculating taxable income, the provisions of the EStG take account of the fiscal treatment in other Member States of maintenance payments in the hands of the recipient. Where a former spouse exercises his or her right to move to another Member State, this influences the possibilities of the party on whom the maintenance obligation rests to deduct the amounts concerned from his or her taxable income and outside the latter's control. There is in other words a direct link between the exercise by the former spouse of a right granted by Community law and the legal position of the other partner under national tax law.

20. Furthermore, as the German Government and the Commission observed in their written submissions, the provisions of the EStG under discussion were introduced into this law in order to comply with the Court's judgment in *Schumacker*.[4] As these provisions, therefore, have a Community law origin, there is an obvious connection with the Treaty. Where a national law is adapted in such a way as to remove an obstacle to free movement, this does not exclude it from the scope of Community law. Rather, this confirms that there is an inherent substantive link with the provisions of the Treaty. Where such a link exists the possibility of judicial review of the compatibility with Community law of both the content and the application of the adapted national provisions should remain available.

21. In the light of my observations in paragraph 18, I consider that this case could have been approached from the angle of Article 56 EC rather than that of Article 12 EC. However, as the question posed by the national court is confined to the effects of Article 12 EC and the further analysis

4 — Case C-279/93 [1995] ECR I-225

mutatis mutandis would be materially the same under either provision, I will answer the question as submitted. It is at any rate clear that, where for the purposes of determining the amount of taxable income account is taken in national legislation of circumstances pertaining in another Member State, such a situation falls within the ambit ratione materiae of Community law and may therefore be reviewed in the light of Article 12 EC.

2. Is there discrimination on grounds of nationality?

22. Under the system of the EStG maintenance payments made by a taxable person to a divorced spouse, resident in Germany, may be deducted from the income tax declaration of the former without any proof having to be provided that these payments were taxed on the side of the recipient. Such proof has to be provided, however, where the recipient is resident in another Member State of the European Union. It is also established that if the former Mrs Schempp had been resident in Germany, Mr Schempp would have been entitled to the deduction of the maintenance payments, which has now been refused him as his ex-wife has taken up residence in Austria. The question is whether this difference in treatment amounts to discrimination on grounds of nationality prohibited by Article 12 EC.

23. Mr Schempp alleges that the differential treatment described indeed infringes Article 12 EC where the terms of deductibility of maintenance payments under the EStG are dependent on the criterion of residence. Although recognising that such discrimination may be justified on grounds of fiscal cohesion, he points out that the Court has stressed that this ground can only be invoked where the initial tax disadvantage suffered by a taxable person is compensated by a tax advantage for the same person.

24. Presuming that Article 12 EC can indeed be invoked in the present case (quod non, in their view), the German and Netherlands Governments state that the difference in treatment at issue is the consequence of disparity between the tax laws of Germany and the other Member States. Moreover direct taxation is an area which falls wholly within the competence of the Member States.

25. The Commission points out that in the circumstances of the present case unequal treatment could result from the fact that, although the amounts concerned would not be taxable either in Germany (where they fall under the threshold set for taxation) or in Austria (general exoneration), the deduction from Mr Schempp's income tax declaration would only be permitted in the former situation. Nevertheless, the Commission takes the view that the two situations cannot be compared with each other. The fiscal

treatment of maintenance payments must not be seen in isolation from the way in which other sources of income are taxed and may benefit from exceptions.

26. As the Court has stated repeatedly, discrimination arises through the application of different rules to comparable situations or the application of the same rule to different situations. Applied to the circumstances of the present case, it must be examined whether it is correct to compare the situation of Mr Schempp, who pays a maintenance allowance to his former spouse resident in Austria and is not permitted to deduct these amounts from his income tax declaration, with the situation of a person, who pays such amounts to a former spouse resident in Germany and is eligible for this tax facility.

27. On a micro level, i.e. viewed from the perspective of the individual taxpayer, it would seem to be quite clear that the differential treatment resulting from the relevant provisions of the EStG may be perceived as being discriminatory and that this difference of treatment on the basis of the place of residence of the recipient of the maintenance allowance could be regarded as indirect discrimination on grounds of nationality. After all, to Mr Schempp it is immaterial, for the purposes of the payments made, where his former spouse resides. Despite the apparent similarity of these circumstances, he is confronted with negative financial consequences of the difference in treatment under the tax law.

28. Although the result of the application of the relevant provisions of the EStG in the circumstances of this case may be to deny Mr Schempp an advantage which he would have enjoyed if his former spouse had been resident in Germany, the basic question for the purpose of applying the discrimination test of Article 12 EC is whether the criterion on which this differential treatment is based relates directly or indirectly to nationality.

29. The criterion used in Paragraph 1a(1), point 1, EStG is that the beneficiary is not wholly liable to income tax, that he or she is resident in a Member State of the European Union or of the European Economic Area and that proof of taxation is provided. These factors relate wholly to the fiscal treatment of the maintenance payments in the Member State of residence of the recipient and do not in any way, either directly or indirectly, concern nationality or residence as such.

30. In asserting that Paragraph 1a(1), point 1, EStG infringes Article 12 EC, Mr Schempp compares his situation with that of a taxpayer who pays a maintenance allowance to a divorced spouse resident in Germany. To my mind these situations are not comparable. In the latter situation both partners are subject to the tax legislation of one Member State. In this situation there is a logical and systematic relationship between permitting a deduction of maintenance payments on the side of the taxpayer responsible for paying the maintenance allowance and the taxability of these amounts as income on the side of the recipient of these payments. The amounts

concerned are, in principle, subject to income tax within the same system. The situation of Mr Schempp, by contrast, is characterised by the fact that the tax legislation of two Member States is involved. In this situation there is no systematic link between the fiscal treatment of Mr Schempp's income and his former spouse's income. Indeed, it would seem to be quite irrelevant from the point of view of gathering revenue in Germany whether or not the maintenance payments are taxed in Austria.

31. The difference in treatment, therefore, is the result of a disparity between the tax laws of Germany and Austria, as was observed by the German and Netherlands Governments and by the Commission. The area of direct taxation still falls, in the present stage of development of Community law, wholly within the competence of the Member States, albeit that they must exercise this competence respecting the fundamental provisions of the EC Treaty. Germany and Austria are therefore at liberty to subject maintenance allowances paid to a divorced spouse to the tax regime they deem fit. It is inherent to this situation that differences in treatment will occur between the Member States and that these differences will also take effect where national tax legislation takes account of external circumstances in the manner employed in the EStG.

32. The criterion used in Paragraph 1a(1), point 1, EStG is neutral. The effects it has on taxpayers depend wholly on the fiscal treatment of maintenance in the various Member States. Thus, it is illustrative to note, together with the Netherlands Government, that had the former Mrs Schempp decided to move to the Netherlands where maintenance allowances are subject to taxation, Mr Schempp would have been able to benefit fully from the possibility of deducting these payments from his income tax declaration.

33. More generally, as the Court has recognised on various occasions 'the EC Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage in terms of indirect taxation or not, according to circumstance. ...'[5] It would appear to me that the same principle applies to the situation which is the subject of the present proceedings where the person concerned has not actively exercised his right to move, but is the passive subject of differential treatment following his former spouse's move to another Member State.

5 — Case C-365/02 *Lindfors*, judgment of 15 July 2004, ECR I-7183, paragraph 34 of the judgment, and Case C-387/01 *Weigel*, judgment of 29 April 2004, ECR 4981, paragraph 55 of the judgment.

34. On a more general level it may seem to be quite unsatisfactory that Mr Schempp is not able to deduct the amounts paid in maintenance allowance from his income tax declaration. As I observed earlier, it makes no difference to him for the purposes of making the maintenance payments where his former spouse lives. This situation is, however, the consequence of a lack of coordination between the tax systems of the Member States and can only be resolved by the Community legislature.

35. On the basis of these observations, I conclude that the answer to the first preliminary question must be that Article 12 EC does not preclude a Member State from refusing a taxpayer resident in Germany entitlement to deduct maintenance payments to his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany on the basis of provisions such as Paragraph 1a(1), point 1, and Paragraph 10(1), point 1, EStG.

B — *The second question*

36. In case the answer to the first preliminary question is negative, the Bundesfinanzhof next inquires whether it is incompatible with Article 18(1) EC for a Member State to refuse a taxpayer entitlement to deduct maintenance payments to his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany.

37. Mr Schempp takes the view that Article 18(1) EC guarantees not only the right to move and stay in other Member States, but also the right to choose the place of residence. In the situation that maintenance payments cannot be deducted from the taxable income where the recipient resides in another Member State this could restrain him or her from leaving Germany, thus causing a restriction to exercise the rights guaranteed by Article 18(1) EC. This pressure could be quite concrete at the moment of determining the amount of the maintenance allowance, as this is done taking the tax consequences into account.

38. The German and Netherlands Governments and the Commission do not consider that Mr Schempp is in any way restricted in his freedom to exercise his rights under Article 18(1) EC as a result of the relevant provisions of the EStG. The Commission states that even if this Treaty provision is to be understood as containing a general prohibition of all restrictions to move within the European Union, the refusal of the tax advantages sought by Mr Schempp are sufficiently justified for the reasons it set out in its answer to the first preliminary question.

39. As I remarked earlier, the relationship between the provisions of the EStG at issue in this case and the freedoms guaranteed by Article 18(1) EC is rather tenuous. It is difficult to imagine how they could restrain Mr Schempp from exercising these rights. Despite Mr Schempp's contention, they did not in fact prevent his former spouse from

moving to a Member State which, as a matter of principle, does not subject maintenance allowances paid to divorced spouses to income tax, thus creating a tax disadvantage for him. It also does not appear from the case file that he first attempted to persuade Mrs Schempp to take up residence, e.g. in the Netherlands, where these amounts are taxed and consequently could have been deducted from his taxable income.

40. I am therefore of the opinion that Article 18(1) EC does not preclude a Member State from refusing a taxpayer, resident in Germany, entitlement to deduct maintenance payments to his divorced spouse, resident in Austria, whereas he would be entitled to do so were she still resident in Germany on the basis of provisions such as Paragraph 1a(1), point 1, and Paragraph 10(1), point 1, EStG.

V — Conclusion

41. In the light of the foregoing observations I would suggest to the Court to give the following answers to the preliminary questions submitted by the Bundesfinanzhof:

1. National provisions such as Paragraph 1a(1), point 1, and Paragraph 10(1), point 1, of the Einkommensteuergesetz, according to which a taxpayer resident in Germany is not entitled to deduct maintenance payments to his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany, are not incompatible with Article 12 EC.

2. National provisions such as Paragraph 1a(1), point 1, and Paragraph 10(1), point 1, of the Einkommensteuergesetz, according to which a taxpayer resident in Germany is not entitled to deduct maintenance payments to his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany, are not incompatible with Article 18(1) EC.