OPINION OF ADVOCATE GENERAL MISCHO

delivered on 26 January 1999 *

1. In proceedings between Eurowings Luftverkehrs AG ('Eurowings'), an aviation company incorporated under German law, and the Finanzamt (Tax Office) Dortmund-Unna concerning payment of the 'Gewerbesteuer' (trade tax), the Finanzgericht Münster has asked the Court to give a preliminary ruling on the interpretation of Article 59 of the EC Treaty in relation to certain aspects of the Gewerbesteuergesetz (Trade Tax Law, 'the GewStG').

The national rules

2. Paragraph 2 of the GewStG of 21 March 1991 [1] provides that any permanent business establishment operating in Germany is subject to trade tax.

3. Trade tax is a non-personal tax on the business establishment as such, irrespective of the resources or the personal circumstances of the taxpayer owning the establishment.

4. Paragraph 6 of the GewStG provides that the taxable amount consists of the trade earnings and the trade capital. [2]

5. 'Trade earnings' are the profits of the business establishment, determined in accordance with the income tax laws or the corporation tax laws. These profits are subject to certain add-backs and deductions, in accordance with Paragraphs 8 and 9 of the GewStG. The purpose of the add-backs and deductions is to determine the objective earnings of the business, irrespective of whether the capital employed belongs to the business itself or to a third party.

* Original language: French.

1 — BGBl. I, p. 814.

2 — Since 1 January 1998 the taxable amount has been limited to the trade earnings.

6. Thus Paragraph 8 of the GewStG, entitled 'Add-back to the taxable amount', provides in subparagraph (7) that there must be added to the earnings of the business:

'half of the rental payments made for the use of fixed business assets, other than real property, owned by another person. This does not apply where the payments are to be taken into account for the purposes of trade tax on the lessor's earnings, unless the lease is of an undertaking (*Betrieb*) or part of an undertaking and the rental payments exceed DEM 250 000. The amount to be taken into account is that which the lessee has to pay to a lessor for the use of business assets which he does not own in the business establishment within a municipality'.

7. The GewStG therefore generally supposes that the net income derived from the leased asset corresponds to one half of the rental paid.

8. 'Trade capital' corresponds to the value for tax purposes of the business capital determined in accordance with the law laying down the criteria for assessment, adjusted to take account of the amounts added back pursuant to Paragraph 12(2) of the GewStG and the deductions provided for in Paragraph 12(3) of the GewStG. The purpose of these add-backs and deductions is to determine the capital belonging to the business and to third parties which is objectively employed in the business.

9. Paragraph 12(2)2 of the GewStG, entitled 'Trade capital', thus provides that the following amounts are to be added to the taxable value of the business:

'the (current) value of business assets, other than real property, used for the purposes of the business but owned by a member of the business or by a third party, to the extent that they are not included in the taxable value of the business. This does not apply where the assets form part of the lessor's trade capital, unless a business or part of a business is leased and the (current) value of the leased assets of the business (or part of a business) included in the lessor's trade capital exceeds DEM 2.5 million. The amount to be taken into account is the total value of the business assets made available by the lessor to the lessee for use in the business establishment within a municipality'.

10. Like the second sentence of Paragraph 8(7) in relation to rental payments, the second sentence of Paragraph 12(2)2 thus provides that the value of business assets owned by a third party is not to be added back in so far as those assets are already subject to trade tax in the hands of the lessor.

11. It is apparent from the observations submitted to the Court by Eurowings that trade tax is calculated in two stages. First, trade capital is subject to a 'tax coefficient' set at a uniform rate throughout Germany at 0.2% for trade capital and 5% for trade earnings; the 'weighted taxable amount' thus obtained is then multiplied by a 'rate' determined by each municipality. In 1993 this rate varied between 0%, notably in the municipality of Norderfriedrichskoog (Schleswig-Holstein), and 515% in Frankfurt-am-Main. In Dortmund, where Eurowings has its registered office, the rate applicable in 1993 was 450%.

Background to the dispute

12. Eurowings operates scheduled and charter flights in Germany and in Europe. In 1993 it leased an aircraft from Air Tara Ltd, a company incorporated under Irish law based at Shannon; the rental was DEM 467 914. The current value of the aircraft, calculated according to its use on German territory, was DEM 1 320 000. By decision of 21 May 1996 the Finanzamt Dortmund-Unna assessed the trade tax payable for 1993 by adding back to the trade earnings, in accordance with Paragraph 8(7) of the GewStG, half the rental payments actually made, namely DEM 233 957. Pursuant to Paragraph 12(2) of the GewStG the Finanzamt also added back the current value of the leased aircraft, DEM 1 320 000, to the trade capital.

13. On 13 June 1996 Eurowings lodged a complaint against the decision of the Finanzamt Dortmund-Unna, which the latter rejected by decision of 8 July 1996. On 11 July 1996 Eurowings brought an action before the Finanzgericht Münster; it claimed that Paragraphs 8(7) and 12(2) of the GewStG were incompatible with Article 59 et seq. of the EC Treaty.

14. The Finanzgericht observes that under Community law Eurowings is able to rely on discrimination contrary to Article 59 of the Treaty even though such discrimination does not directly affect Eurowings but affects the lessor incorporated under Irish law.

15. The Finanzgericht further observes that Irish limited companies are comparable to

German share companies within the meaning of Paragraph 1 of the German corporation tax law and that if such companies leased aircraft in Germany their activities would be regarded entirely as business activities under Paragraph 2(2) of the GewStG.

16. The Finanzgericht points out that the scheme of the add-back provisions relating to trade tax is based on the legislative intention to ensure that the asssets employed by a domestic business undertaking are taxed, and taxed only once, irrespective of whether they were financed by the business or from outside and of whether the trade capital is owned by the undertaking for the purposes of civil law. This was achieved by adding back rental payments and the value of the economic assets to the earnings of the business. It is necessary in such a system, therefore, for an exception to be made in cases where the rental payments or assets in question are already subject to trade tax in the hands of the lessor.

17. The national court observes, however, that the fiscal treatment of a lessee who leases an asset from a lessor established in another Member State is less favourable than where the lessee leases such an asset from a lessor established in Germany, which might constitute covert discrimination contrary to Article 59 of the Treaty.

18. The national court considers it doubtful whether the intention to ensure coherence of taxation can justify the add-back provisions of the GewStG. The Court of Justice has held [3] that the aim of ensuring the cohesion of the tax system can justify a difference in treatment between residents and non-residents only where the fiscal disadvantage imposed on the national of a Member State is compensated by a corresponding fiscal advantage which that national is able to enjoy, so that in reality there is no discrimination against him. A mere link between the fiscal advantage conferred on one taxpayer and the unfavourable fiscal treatment of another taxpayer cannot justify discrimination between residents and non-residents. In that regard, the national court observes that in a decision of 30 December 1996 [4] the Bundesfinanzhof considered that there was serious doubt whether the add-back provisions in the second sentence of Paragraph 8(7) and the second sentence of Paragraph 12(2)2 of the GewStG were compatible with the prohibition on discrimination in Article 59 et seq. of the Treaty, although it had accepted in an earlier decision that they were. [5]

3 — Case C-80/94 *Wielockx* v *Inspecteur der Directe Belastingen* [1995] ECR I-2493 and Case C-484/93 *Svensson and Gustavsson* v *Ministère du Logement et de l'Urbanisme* [1995] ECR I-3955.

4 — BStBl. II, 1997, p. 466.

5 — Judgment of 15 June 1983 (BStBl. II, 1984, p. 17).

19. Last, the Finanzgericht wonders whether it is necessary to take into consideration the fact that the Irish lessor pays no tax comparable to the German business tax and enjoys 'Shannon privileges' in the form of corporation tax at 10%. In the present case such fiscal advantages might neutralise the theoretical restriction of freedom to provide services and mean that if the lessor enjoyed the same exceptions to the add-back provisions as German lessors it would be the latter that were victims of discrimination. The Finanzgericht is not certain that such an argument can be upheld, however, since the Court has also held that the compensation of fiscal disadvantages by other fiscal advantages cannot justify discrimination. [6]

20. The Finanzgericht Münster therefore decided to refer the following question to the Court for a preliminary ruling:

'Are the add-back provisions in the second sentence of Paragraph 8(7) and the second sentence of Paragraph 12(2)2 of the [GewStG] compatible with the principle of freedom to provide services under Article 59 of the Treaty on European Union of 7 February 1992?'

Preliminary observation

21. As the Commission correctly observes, the question as formulated is inadmissible, since the Court is requested to rule on the compatibility of provisions of German law with Community law.

22. The Court has consistently held, however, that although the Court may not, under Article 177 of the Treaty, rule on the validity, in regard to Community law, of a provision of domestic law, as it would be possible for it to do under Article 169 of the Treaty, it nevertheless has jurisdiction to supply the national court with an interpretation of Community law on all such points as may enable that court to determine the issue of compatibility for the purposes of the case before it. [7]

23. The question referred by the Finanzgericht Münster must therefore be understood as seeking to ascertain, in essence, whether Article 59 of the Treaty prohibits national rules such as those laid down in the second sentence of Paragraph 8(7) and the second sentence of Paragraph 12(2)2 of the GewStG.

6 — Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 21, and Case C-107/94 *Asscher* v *Staatssecretaris van Financiën* [1996] ECR I-3089.

7 — See, in particular, Joined Cases C-304/94, C-330/94, C-342/94 and C-224/95 *Tombesi and Others* [1997] ECR I-3561.

Analysis

Principles laid down in the case-law of the Court

24. I shall begin by examining the principles laid down in the Court's case-law which are material to the issue before the Court. The dispute before the national court falls within the field of direct taxation. The Court has consistently held that '[a]lthough, as Community law stands at present, direct taxation does not, as such, fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law'. [8] In this field too, therefore, the Member States must observe the fundamental freedoms laid down in the Treaty, including the freedom to provide services.

25. Second, it should be observed that the provisions at issue are drafted in neutral terms, in that they are in no way meant to apply specifically to providers of services of another nationality or to those intending to carry out their activities in Germany while based in another Member State. In the present case, moreover, it is the application of that provision to a German company operating in Germany that is disputed.

26. The situation in question therefore concerns a restriction which is indirect, in the sense that the application of the German law to a German undertaking has the effect of dissuading it from having recourse to the services offered by a provider of services established in another Member State.

27. As the Finanzgericht Münster, Eurowings and the Commission have correctly pointed out, it follows from the case-law [9] that Article 59 of the Treaty confers subjective rights not only on the provider of services but also on the recipient.

28. As regards the matters prohibited by Article 59 of the Treaty, the Court has consistently held that that provision may be infringed not only where there is direct discrimination based on nationality or indirect discrimination based on the residence of the provider of services, but also where national rules applicable to all traders without distinction have the effect of making the provision of services between Member States more difficult than the provision of services purely within one Member State. [10]

8 — See, in particular, Case C-279/93 *Finanzamt Köln-Altstadt* v *Schumacker* [1995] ECR I-225, paragraph 21.

9 — See, in particular, Joined Cases 286/82 and 26/83 *Luisi and Carbone* v *Amministrazione delle Finanze dello Stato* [1984] ECR 377 and *Svensson and Gustavsson*, cited above.

10 — See, in particular, case C-381/93 *Commission* v *France* [1994] ECR I-5145, paragraph 17.

Impact of the rules in issue

29. Having outlined the framework established by the Court's case-law, I can now go on to consider the rules at issue.

30. It should be noted at the outset that the *objective* pursued by the German legislature, as described by the Finanzgericht (point 16 above), is not something which is open to challenge.

31. Nor can the principle that a German lessee is subject to the Gewerbesteuer, irrespective of the State of establishment of the lessor, be subject to challenge, it being merely an instance of the fiscal sovereignty of the Federal Republic of Germany.

32. Where the problem does arise, on the other hand, is at the level of the *rules* which determine how the lessee is taxed, depending upon whether the lessor is in Germany or in another Member State.

33. The German legislature has provided that the lessee is exempt from the add-back procedure if the amounts which should have been added back are already assessed for the purposes of the Gewerbesteuer in the hands of the lessor, which by definition can never be so where the lessor is established in another Member State.

34. The Finanzgericht Münster has already drawn the following conclusion in the order for reference: [11]

'Comparison between domestic and foreign lessors means... that payments to a foreign lessor entail a fiscal disadvantage for a person subject to domestic trade tax, which may be in breach of the prohibition of discrimination in the EC Treaty where the foreign lessor has the nationality of another Member State or has its seat or head office there'. The Finanzgericht goes on to state that this system represents a competitive disadvantage for a provider of services established in another Member State, since it 'may lead the German lessee — all other things being equal — to contract with a German lessor'.

35. As thus described by the national court, the national rules and their effects give reason to think that they constitute a restriction on freedom to provide services.

11 — Part II, 5(a), third paragraph.

36. That they do is disputed, however, by the Finanzamt Dortmund-Unna and by the German Government, who put forward four arguments in that regard.

Arguments put forward in defence of the rules in issue

37. The German Government maintains, first, that the contested provisions entail not only no direct discrimination but also no 'hidden indirect discrimination' against providers of services established in other Member States, because lessees are also required to add back the relevant amounts in respect of assets leased from lessors established in Germany *where the lessors are not subject to the GewStG.*

38. That would be the case where a chemist who had ceased to practise granted a lease on his chemist's shop in Germany. Since he no longer had any business activity the chemist would not be liable to trade tax. The lessee's activity would be subject to that tax, however, and it would therefore be necessary to add back to the earnings of that activity half the rental payments made in respect of the chemist's shop, in accordance with the first sentence of Paragraph 8(7) of the GewStG.

39. That would also be the case where the lessor was exempt from trade tax or where, like the Federation, the *Länder* or the municipalities, it was exempt as a sovereign authority. Thus where a harbour town leased a crane to a harbour company it would be necessary, pursuant to the first sentence of Paragraph 8(7) of the GewStG, to add back half the rental payments to the company's earnings.

40. Eurowings and the Commission point out, however, that it is only in very rare cases that domestic lessors are not liable to pay trade tax. Depending on the type of activities in which they are involved, entities which are not subject to the GewStG engage in rental or leasing operations only on an ancillary basis and occasionally, if at all.

41. In the light of what was submitted at the hearing that fact can be regarded as established.

42. Rules in a Member State which confer a fiscal advantage on the majority of domestic operations and always deprive cross-border operations of that advantage

undeniably constitute a restriction on the freedom to provide services.

43. In *Safir* [12] the Court held that the tax at issue in that case was capable of being higher *in the majority of cases* than the tax on purely domestic operations.

44. The German Government attempts, second, to justify the tax scheme in question by the need to preserve the cohesion of the tax system, which was upheld by the Court in *Bachmann.* [13]

45. The Commission contends that the situation at issue in that case was not comparable, since the disadvantage suffered by the taxpayer (non-deduction of insurance premiums) was counterbalanced as far as the taxpayer was concerned by a subsequent advantage (non-taxation of the insured amount).

46. The national court and Eurowings correctly point out, moreover, that in the recent *Wielockx* and *Svensson and Gustavsson* judgments the Court held that there must be a direct link between the deduction made and the unfavourable tax consequence. There is no such link in the present case, since the more favourable fiscal treatment of one taxable person, the lessee, is motivated by the collection of tax from another taxable person, the German lessor. On this point they also refer to a decision of the Bundesfinanzhof of 30 December 1996 [14] to the effect that:

'Such a direct link is in any event lacking where the preferential tax arrangement applies to one taxable person whereas the fiscal disadvantage dictated by cohesion affects another taxable person; there the relationship between the two tax rules is only indirect.

The same applies to the rules provided for by the trade tax: the possibility that the rental or lease payments and the value of the leased asset may be deducted by the taxable person in his capacity as lessee is only justified, according to the principle of single taxation inherent in the trade tax, by the fact that the corresponding sums are taxed in the hands of another taxable person, the lessor. The prohibition on effecting such a deduction where the lease is concluded with a lessor established in another Member State of the Community is therefore liable to restrict the freedom to provide services. The fact that that ultimately makes no difference, because the amount of the rental payments is influenced either by the fiscal burden in the form of trade tax borne by the lessor or by that

12 — Case C-118/96 *Safir* v *Skattemyndigheten i Dalarnas Län* [1998] ECR I-1897.

13 — Case C-204/90 *Bachmann* v *Belgian State* [1992] ECR I-249.

14 — Cited above.

borne by the lessee, is irrelevant. The decisive factor is that the (domestic) lessee may be encouraged to deal with domestic lessors rather than with those established abroad in order to avoid the fiscal charge resulting from the add-back provisions in Paragraphs 8(7) and 12(2)2 of the GewStG. The market opportunities of foreign competitors in comparison with those of a domestic competitor with the same offer are therefore reduced.

... It is extremely doubtful whether the add-back provisions in the second sentence of Paragraph 8(7) and the second sentence of Paragraph 12(2)2 of the GewStG are compatible with the prohibition on discrimination in Article 59 of the EC Treaty.'

47. Eurowings observes that since the Bundesfinanzhof was required to determine a procedural issue, namely an application to suspend enforcement of the fiscal decision, rather than the substance of the case, it was unable to refer the matter to the Court for a preliminary ruling.

48. The Bundesfinanzhof's analysis is in any event entirely consistent with the Court's case-law, including on the question of fiscal cohesion. An overriding requirement associated with the need to preserve the cohesion of the tax system cannot therefore be accepted in the present case.

49. Third, the German Government claims that there is no longer any justification for adding back the relevant amounts to the lessee's taxable amount where the (German) lessor is also liable to pay the trade tax, since to do so would lead to double taxation of the rental payments and the value of the leased assets. Where an asset is supplied by a lessor who is liable to pay the GewStG the lessor incorporates the tax in the amount of the rental payments and thus passes it on to the lessee. From an economic aspect it is therefore the lessee who ultimately bears the tax burden.

50. That argument seeks in essence to demonstrate that in all circumstances it is the lessee who bears the tax burden. Where the lessor is not subject to the GewStG the lessee pays the tax directly by means of the add-back procedure, whereas where the lessor is subject to the GewStG the lessee pays the tax indirectly by virtue of the fact that the lessor passes it on in the price.

51. I do not find that explanation convincing.

52. As Eurowings observed, without being contradicted by the German Government on that point, in the context of a German lease the lessee is always exempt purely because the lessor is subject to the GewStG, irrespective of the ways in which the latter may avoid actually paying the tax. Unlike a lessee in a cross-border lease, the lessor has

a number of means of reducing the level of the tax, such as, *inter alia*, the fact that it is the book value rather than the market value of the assets that is taken into account, the fact that half rather than the whole amount of the long-term payments are added back, the use of flat-rate financing to purchase the assets in order to reduce the trade capital and the fact that only actual earnings on assets leased in Germany, rather than half the rental payments, are taken into account. Moreover, German banks offer 'leasing funds', the prospectuses of which show that tax on trade earnings is not payable and that tax on trade capital is payable for only part of the contract period. Furthermore, since a lessor of aircraft is not tied to a town with an airport it can establish itself in a municipality which has fixed a very low rate, or even a zero rate, for the GewStG.

53. It may very well be the case, therefore, that in reality the leased assets are not actually taxed in the hands of the German lessor under the GewStG, although the lessee is not subject to the add-back procedure. Thus the advantage which the lessee derives from exemption from the add-back provisions is not in any way linked to the amount paid by the lessor under the GewStG.

54. I also consider that even if the assets were taxed in the hands of the German lessor it would be impossible to conclude that that fiscal burden would be automatically passed on in full in the rental payments in such a way that the burden would be borne by the lessee.

55. Other than in the case of VAT, which is specifically designed to ensure that the actual burden of the tax is borne by the end user, it is never safe to presume that a fiscal charge is the same for the consumer irrespective of whether it is paid by the consumer *qua* taxable person or is paid by the supplier and incorporated in the price.

56. In a competitive system there can be no presumption that a fiscal charge is passed on either in full or automatically in the price of goods or services; whether and to what extent that is so depends entirely on the competitive conditions prevailing in the market at a particular time. There would need to be an agreement in existence between German lessors (and it is by no means certain that such an agreement would be legal) before there could be any guarantee that the fiscal burden would automatically be passed on in full. Even if by some remote chance that were the case, I fail to see how national rules could cease to be illegal merely because their effect was neutralised by the conduct of traders.

57. The German system cannot therefore be regarded as neutral for competition purposes as between German lessors and those established in other Member States. It actually encourages German lessees of fixed assets other than real property to deal with a lessor established in Germany, since such a lessor is able to offer its customers a service the value of which will not be taken into account for the purpose of determining the basis on which the trade tax payable by its customers will be assessed, even though the price of the service does not necessarily include a fiscal charge representing that tax.

58. Fourth, it remains to consider an argument raised by the defendant in the main proceedings, the Finanzamt, to the effect that 'in order to determine whether there is a restriction on the free movement of services, it is necessary to compare the fiscal circumstances as a whole (meaning that in the present case the lower taxes in Ireland must be taken into consideration)'. The national court asks whether it is necessary to take into consideration the fact that the leasing company established under Irish law pays no tax comparable to the German Gewerbesteuer. However, it doubts that such an argument can be upheld, having regard to the Court's case-law. [15]

59. The Finanzgericht's doubts are well founded. One can only share the Commission's opinion that accepting such justification 'would interfere with the foundations of the internal market. If differences in the direct taxation of undertakings could be "neutralised" by compensatory levies imposed by Member States on intra-Community movements of goods, services and capital, little would remain of those fundamental freedoms. Virtually all goods and services moving between Member States would be subject to one compensatory levy or another ... Member States and undertakings must in principle accept differences in fiscal charges in the same way as differences in social charges or labour costs'.

15 — See point 19 above.

60. At the hearing the Agent of the Federal Republic of Germany also accepted that the existence or otherwise of a comparable tax in other Member States was not to be taken into consideration.

61. Last, it remains to consider whether the tax regime in issue is the only one capable of allowing the Federal Republic of Germany to achieve the objective pursued, or whether there are other means of attaining that objective.

62. One possible method might be to reduce the charge represented by the Gewerbesteuer on the 'transnational' provision of services to the level applicable in the case of the 'domestic' provision of services. This method must remain purely theoretical, however, as long as the rate of the GewStG may vary between 0% and 515%, depending on the municipality concerned, and as long as the question whether the Gewerbesteuer is or is not passed on to the lessee by the lessor remains wholly uncertain.

63. Another method of achieving equality of treatment would be to require the lessee to add back the relevant amounts even where the leasing contract was concluded with a German lessor and, in return, to exempt the lessor from the trade tax.

64. In so doing the German authorities might find inspiration in the system already applicable where an undertaking (*Betrieb*) or part of an undertaking is leased and the rental payments exceed DEM 250 000 (see the 'exception to the exception' in the second sentence *in fine* of Paragraph 8(7)).

65. The law provides that where the rental payments have thus been added back to the hirer's or lessee's business assets the basis for assessment of the tax is reduced by a corresponding amount in the hands of the lessor or owner of the leased assets (Paragraph 9(4) of the GewStG).

66. For lease agreements of this type the same rules applied to the determination of the trade capital (Paragraph 12(2)2 and (3)3) until 31 December 1997, the date on which this capital ceased to be taken into account for the purpose of determining the trade tax.

67. The system at issue therefore also fails to meet the condition of being 'objectively necessary' to attain the end pursued.

68. Having completed my reasoning, I must therefore conclude that a system such as that at issue in the main proceedings establishes a restriction on the freedom to provide services because the recipient of a cross-border service is always taxed, whereas it is by no means certain that the recipient of a domestic service is required, in one form or another, to bear a comparable burden or even any burden whatsoever.

Conclusion

69. I therefore propose that the Court answer the question referred by the Finanzgericht Münster in the terms proposed by the Commission, namely that:

Article 59 of the EC Treaty is to be interpreted as prohibiting a Member State from subjecting the recipient of a service to a higher tax on his business if the

provider of the service in question is established in another Member State than if the provider of the service is established in its own territory, by means of provisions on adding back to the taxable amount certain items relating to the earnings and capital of the business.