ORDER OF THE COURT (First Chamber)
12 September 2002 *

In Case C-431/01,

REFERENCE to the Court under Article 234 EC by the Cour d'appel de Mons (Belgium) for a preliminary ruling in the proceedings pending before that court between

Philippe Mertens

and

Belgian State,

on the interpretation of Articles 48 and 52 of the EC Treaty (now, after amendment, Articles 39 EC and 43 EC),

* Language of the case: French.

THE COURT (First Chamber),

composed of: P. Jann, President of the Chamber, M. Wathelet and A. Rosas (Rapporteur), Judges,

Advocate General: S. Alber,
Registrar: R. Grass,

after informing the national court, pursuant to Article 104(3) of its Rules of Procedure, that it proposed to give its decision by reasoned order,

after inviting the persons referred to in Article 20 of the EC Statute of the Court of Justice to submit any observations they might have on that proposal,

after hearing the Advocate General,

makes the following

Order

1 By judgment of 2 November 2001, received at the Court on 7 November 2001, the Cour d'Appel de Mons (Court of Appeal, Mons) referred for a preliminary ruling under Article 234 EC a question concerning the interpretation of Articles 48 and 52 of the EC Treaty (now, after amendment, Articles 39 EC and 43 EC).

2 That question was raised in a dispute between Mr Mertens and the Belgian State concerning his assessment to personal tax for the 1990 tax year, relating to income earned in 1989.

Legal framework

3 Article 5 of the Belgian Income Tax Code 1964, in the version resulting from the Royal Decree of 26 February 1964 consolidating statutory provisions on income tax (*Moniteur Belge* of 10 April 1964, p. 3809, hereinafter 'the 1964 Code'), provides:

'Residents of the Kingdom shall be liable to personal tax on all their taxable income covered by this Code, even if part of that income has been generated or received abroad.'

4 The first paragraph of Article 43 of the 1964 Code, which governs the determination of the net amount of earned income, provides:

'1 related business expenses or costs shall be deducted from the gross income from each business activity or employment;

2 business losses incurred during the taxable period in respect of any business activity or employment shall be deducted from the income from other activities;

3 business losses incurred during the previous five taxable periods shall be set off against earned income as determined in accordance with points 1 and 2 of this Article; they shall be successively set off against earned income for each of the subsequent taxable periods, but may not be set off against the proportion of earned income relating to any taxable period or fraction of a taxable period beyond a term of five years calculated from the day following the taxable period during which the business loss has been incurred;

...'

5 Article 13c of the Royal Decree of 4 March 1965 implementing the 1964 Income Tax Code (*Moniteur Belge* of 30 April 1965, p. 4722), states:

'Business losses incurred during the taxable period in a particular business activity or employment shall be set off in accordance with the proportional rule against income earned from other business activities or employment which are taxed together or are exempt under Article 87c of the Income Tax Code; any balance shall be set off in accordance with the proportional rule against the various earned income taxed separately.'

6 Article 87c of the 1964 Code, which incorporates into the tax legislation the principle that income received by a Belgian resident in a country with which the Kingdom of Belgium has concluded a double taxation convention is exempted from tax in Belgium, reads as follows:

'Income exempted under international double taxation conventions shall be taken into account for calculating tax, but tax shall be reduced according to the proportion of the overall income represented by the exempted income.'

7 The Kingdom of Belgium has concluded bilateral conventions with all the other Member States for the avoidance of double taxation. All those conventions are based on a model established by the Organisation for Economic Cooperation and Development (OECD). The Convention between the Kingdom of Belgium and the Federal Republic of Germany for the avoidance of double taxation ('the Convention') was signed in Brussels on 11 April 1967 and approved by the law of 9 July 1969 (*Moniteur Belge* of 30 July 1969).

8 Under Article 15(1) of the Convention, '[s]alaries... derived by a resident of a Contracting State in respect of all employment shall be taxable only in that State, unless the employment is pursued in the other Contracting State. If that is the case, such remuneration as is derived therefrom may be taxed in that other State.'

9 Under Article 23(2)(1) of the Convention, income from Germany, which is taxable in that Contracting State by virtue of the Convention, is exempt from tax

in Belgium. The same provision states that the exemption does not limit the right of the Kingdom of Belgium to take the income thus exempted into account for the purposes of determining tax rates.

The dispute in the main proceedings and the question referred for a preliminary ruling

10 The claimant in the main proceedings, Mr Mertens, is a computer consultant resident in Belgium. During the years 1988 and 1989, he was at the same time employed in Germany and self-employed in Belgium.

11 For the 1989 tax-year, his self-employed business in Belgium suffered a loss of BEF 279 105, owing largely to the purchase of computer equipment which, it was common ground, was subject to depreciation for tax purposes.

12 In his tax return for the following year, Mr Mertens mentioned the loss that he had incurred in the previous tax year and sought to deduct it from the profit generated by his self-employed business in Belgium. However, when he received his assessment to personal tax for the tax year 1990, he found that the loss carried over had not been taken into account by the Belgian tax authorities.

13 The Regional Directorate of Direct Contributions, Liège, Belgium, rejected Mr Mertens' appeal against that assessment. By a decision notified to him on 16 December 1991, it pointed out that the loss in question had already been taken into account for the 1989 tax year and that, under the combined provisions of point 2 of the first paragraph of Article 43 of the 1964 Code and Article 13c of the Royal Decree of 4 March 1965, the loss had been set off against remuneration from Germany received during the same period. The Convention does not preclude the Belgian State from taking into account, when assessing the taxable amount, income which is taxable in Germany and exempt from tax in Belgium. Consequently, it was possible to carry over the business loss incurred in respect of activities carried on in the latter Contracting State only if that loss had not been covered by income from abroad.

14 On 24 January 1992, Mr Mertens lodged an appeal against that decision before the Cour d'appel de Liège (Court of Appeal, Liège).

15 By interim judgment of 20 April 1994, the Cour d'appel ordered that the proceedings be reopened and requested clarification as to whether German tax law allows business losses incurred in Belgium to be taken into consideration in Germany.

16 On 2 November 1994, the Cour d'appel de Liège gave judgment, declaring Mr Merten's appeal well founded and holding that the loss incurred in Belgium could not be set off against income exempted from tax by the Convention. It held that Article 87c of the 1964 Code allowed exempted income to be taken into account only for the purposes of determining the tax rate and that the reintroduction of that income into the taxable amount 'could lead to a problem of discrimination between Belgians depending on whether or not they carried on some of their activities in certain foreign countries'.

17 On 3 February 1995, the Belgian State appealed on a point of law against that judgment. By judgment of 27 October 1995, the Cour de cassation (Court of Cassation) upheld the tax authority's argument and quashed the judgment of the Cour d'appel de Liège. The case was referred to the Cour d'Appel de Mons.

18 Before that court, Mr Mertens raised the matter of whether the legislation at issue was compatible with Articles 48 and 52 of the Treaty, relying particularly on the judgment delivered by the Court of Justice in Case C-141/99 *AMID* [2000] ECR I-11619. In the circumstances, the Cour d'appel de Mons decided to stay proceedings and to refer the following question to the Court for a preliminary ruling:

'Does Article 39 and/or Article 43 of the Treaty establishing the European Community preclude legislation by a Member State under which, for the purposes of assessment to personal tax, a business loss incurred in that Member State by a natural person residing in that Member State in the course of a previous period of assessment may be deducted from his profit for a subsequent period of assessment only in so far as that loss cannot be set off against remuneration relating to the earlier period of assessment arising from that person's employment in another Member State, the effect of this being that the loss, although set off, cannot be deducted either in that Member State or in the other State from that person's taxable income for the purposes of assessment to personal tax, whereas if he had been employed in the same Member State as that in which he carries on his self-employed activity, the business loss could be properly and lawfully deducted from his taxable income?'

The question referred for a preliminary ruling

19 By its question, the national court is asking essentially whether Article 48 and/or 52 of the Treaty preclude legislation by a Member State under which a natural

person residing and self-employed in that Member State may deduct from the taxable profit for one year, for the purposes of personal taxation, a loss suffered the previous year only on the condition that that loss was not capable of being set off against remuneration received from employment in another Member State during that same previous year, when the loss, although set off, cannot be deducted from taxable income in either of the States concerned, whereas it would be deductible if that person had been both self-employed and employed exclusively in the Member State in which he is resident.

20 Since it considers that the reply to the question referred can be clearly deduced from its case-law, the Court, in accordance with Article 104(3) of its Rules of Procedure, informed the national court that it proposed to give its decision by reasoned order and invited the persons referred to in Article 20 of the EC Statute of the Court of Justice to submit any observations they might have on that proposal.

21 Only the Commission submitted observations within the prescribed period. It expressed its agreement to the Court's proposal to give its decision by reasoned order.

22 It should be noted that, in its judgment in *AMID*, cited above, the Court has already had to interpret Community law, in particular Article 52 of the Treaty, relating to freedom of establishment, in a case which called into question Belgian tax legislation in a situation similar to that of the main proceedings. That legislation allowed a company established in Belgium to deduct a loss incurred the previous year from the taxable profit for the current year only on the condition that that loss was not capable of being set off against the profit made during that same previous year by one of its permanent establishments situated in

another Member State. In that regard, the Court held that Article 52 of the Treaty precludes such legislation since the loss, although set off — in that case, against the profit made by one of the claimant's permanent establishments in Luxembourg — could not be deducted from taxable income in either of the Member States concerned, whereas it would have been deductible if the establishments of that company had been situated exclusively in the Member State in which the company had its seat.

23 The very wording of the question shows that the national legislation at issue in the main proceedings, relating to the deduction of business losses from taxable profits for the purposes of personal tax, lays down a condition similar to that considered by the Court in *AMID*, cited above. Furthermore, it is apparent from the question that the set off of the loss incurred in the State of residence against earned income received by the claimant in the main proceedings in another Member State also has the effect that the loss, although set off, cannot be deducted from taxable income in either of those Member States, whereas it would have been deductible if he had been employed and self-employed exclusively in the Member State in which he is resident.

24 In the main proceedings, the position of Mr Mertens, who suffers a tax disadvantage by reason of the fact that he is employed in a Member State other than that in which he is resident, falls within the scope of Article 48 of the Treaty, relating to the freedom of movement for workers, rather than under Article 52 of the Treaty, which relates to freedom of establishment. In any event, account should be taken of the principles laid down by the case-law of the Court of Justice in respect of freedom of movement for persons, because it relates both to freedom of establishment and freedom of movement for workers.

25 It should therefore be remembered that, according to settled case-law, although direct taxation is a matter for the Member States, they must nevertheless exercise

their direct taxation powers consistently with Community law (see Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 21; Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 19; Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 32; *AMID*, cited above, paragraph 19; and Case C-55/00 *Gottardo* [2002] ECR I-413, paragraph 32).

26 In the exercise of their direct taxation powers, Member States must therefore not infringe Articles 48 and 52 of the Treaty, relating to freedom of movement for persons. Those provisions grant Community citizens a fundamental freedom, which includes the pursuit of occupational activities of all kinds throughout the Community. The provisions therefore preclude any national legislation which might place Community citizens at a disadvantage when they wish to pursue their salaried or self-employed activities beyond the territory of a single Member State (see Case 143/87 *Stanton and 'L'Étoile 1905'* [1988] ECR 3877, paragraph 13; Case C-370/90 *Singh* [1992] ECR I-4265, paragraph 16, and Joined Cases C-393/99 and C-394/99 *Hervein and Others* [2002] ECR I-2829, paragraph 47).

27 Furthermore, it is apparent from the case-law of the Court of Justice that, even though, according to their wording, the provisions concerning freedom of movement for persons are mainly aimed at ensuring that foreigners are treated in the host Member State in the same way as nationals of that State, they also prohibit the State of origin from hindering the exercise of that freedom (*AMID*, cited above, paragraph 21; see, concerning freedom to provide services, Case C-384/93 *Alpine Investments* [1995] ECR I-1141, paragraphs 29 to 31).

28 It should be pointed out that, as regards the calculation of a natural person's taxable income, the legislation of the Kingdom of Belgium limits the possibility — for persons residing in Belgium who are simultaneously self-employed there and employed in another Member State — of carrying over losses incurred in the Member State of residence during a previous taxable period. When such

persons are in the same position as Mr Mertens, that is to say, when, during the same taxable period, they have incurred a loss in Belgium and received remuneration from their employment in Germany, that loss cannot be deducted either from their taxable income in Germany in respect of that year or from their taxable income in Belgium in respect of subsequent years. On the other hand, if a person who has suffered a loss in respect of his self-employed activity in Belgium had been employed in that Member State, the loss would have been set off against other income received and would have been deducted from his taxable income.

29 Thus, by the way losses incurred in Belgium are set off against income from other Member States exempted from tax under conventions to prevent double taxation, the legislation at issue in the main proceedings establishes differentiated tax treatment as between taxpayers who exercise all their activities exclusively on Belgian territory and those who are self-employed in Belgium and employed in another Member State (see to that effect the judgment in *AMID*, cited above, paragraph 23).

30 Admittedly, the legislation applies without distinction to all taxpayers who have suffered losses in respect of a self-employed activity, given that, under point 2 of the first paragraph of Article 43 of the 1964 Code, business losses incurred during a taxable period in respect of any business activity or employment are always to be deducted from income from other activities, including, therefore, remuneration received in respect of employment in Belgium.

31 However, taxpayers who, like Mr Mertens, exercise their right to freedom of movement and are simultaneously self-employed in Belgium and employed in another Member State, are not in a position comparable to that of taxpayers who carry on all their occupational activities exclusively in Belgium. Under double

taxation agreements such as the Convention, remuneration received in respect of employment is taxable in the Contracting State in which the person concerned is employed, even if the worker resides in the other Contracting State. Furthermore, it has been established during the main proceedings that the loss incurred in Belgium could not be taken into account for determining taxable income in Germany, because the activity carried on in the latter Member State was salaried.

32 However, it is settled law that there is unequal treatment when two categories of persons, whose legal and factual circumstances are not fundamentally different, are treated differently and when situations which are not comparable are treated in the same way (see, to that effect, Case 8/82 *Wagner* [1983] ECR 371, paragraph 18; Case 283/83 *Racke* [1984] ECR 3791, paragraph 7; Case C-391/97 *Gschwind* [1999] ECR I-5451, paragraph 21; and Joined Cases C-122/99 P and C-125/99 P *D and Sweden* v *Council* [2001] ECR I-4319, paragraph 48).

33 Therefore, the legislation at issue in the main proceedings leads — as does the national legislation considered by the Court of Justice in *AMID*, cited above — to unequal treatment. It is likely to dissuade a taxpayer who is in the position of the claimant in the main proceedings from entering into or continuing with employment in another Member State. The legislation thus creates a hindrance to the freedom of movement for workers guaranteed by Article 48 of the Treaty (see, concerning freedom of establishment, *AMID*, cited above, paragraph 27).

34 Since, as a general rule, employment produces a profit rather than a loss, the Belgian Government's argument that the restricting effects of the tax legislation on freedom of movement are too uncertain and indirect for that measure to be classified as a hindrance should be discounted.

35 In any event, even if, as the Belgian Government claims, the legislation at issue in the main proceedings has, on the whole, favourable or at least neutral consequences for individuals who avail themselves of their Community freedom of establishment or movement, the fact remains that it is clearly disadvantageous to persons who find themselves in a position like Mr Merten's merely because they are employed in another Member State.

36 As regards the Belgian Government's argument that the disadvantage suffered by Mr Mertens is the result only of the inevitable differences between the various Member States' national legislation and exercise of tax powers by their authorities, it must be pointed out that the unfavourable tax treatment of which the claimant in the main proceedings complains is the direct result of the application of the Belgian legislation, not of an inevitable disparity between the Belgian and German tax legislation.

37 As for the objection that only measures which are openly or clearly discriminatory may be described as restrictive of the freedoms guaranteed by Articles 48 and 52 of the Treaty, it should be remembered that, to be regarded as contrary to the freedom of movement guaranteed to Community citizens, a national measure does not have to be openly discriminatory. It need only be liable to hamper that fundamental liberty or render it less attractive (see, to that effect, Case C-19/92 *Kraus* [1993] ECR I-1663, paragraph 32).

38 In order to justify the restriction on freedom of movement for workers guaranteed by Article 48 of the Treaty, the Belgian Government merely invokes the principle, referred to in Article 5 of the 1964 Code, that a taxpayer's worldwide income should be taxed by his State of residence, and the fact that the Convention does not preclude the taking into account of income received in Germany for calculation of the basic taxable amount in Belgium.

39 However, it should be pointed out that those arguments, based on national law and the Convention, do not show that the national legislation at issue in the main proceedings is pursuing a legitimate objective compatible with the Treaty or that application of that legislation does not go beyond what is necessary to achieve that objective.

40 Having regard to the foregoing, and without there being any need to give a ruling on the interpretation of Article 52 of the Treaty in the light of the facts in the main proceedings, the reply to the question raised must be that Article 48 of the Treaty precludes legislation by a Member State under which a natural person residing and carrying on a self-employed business in that Member State may, for the purposes of personal taxation, deduct from his taxable profit for one year a loss incurred the previous year only on the condition that that loss was not capable of being set off against remuneration received from employment in another Member State during that same previous year, when the loss, although set off, cannot be deducted from taxable income in either of the Member States concerned, whereas it would be deductible if that person had been both self-employed and employed exclusively in the Member State in which he is resident.

Costs

41 The costs incurred by the Belgian Government and by the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (First Chamber),

in answer to the question referred to it by the Cour d'appel de Mons by judgment of 2 November 2001, hereby orders:

Article 48 of the EC Treaty (now, after amendment, Article 39 EC) precludes legislation by a Member State under which a natural person residing and carrying on a self-employed business in that Member State may, for the purposes of personal taxation, deduct from his taxable profit for one year a loss incurred the previous year only on the condition that that loss was not capable of being set off against remuneration received from employment in another Member State during that same previous year, when the loss, although set off, cannot be deducted from taxable income in either of the Member States concerned, whereas it would be deductible if that person had been both self-employed and employed exclusively in the Member State in which he is resident.

Luxembourg, 12 September 2002.

R. Grass

Registrar

P. Jann

President of the First Chamber