JUDGMENT OF THE COURT (Fifth Chamber)

12 December 2002 *

In Case C-385/00,

REFERENCE to the Court under Article 234 EC by the Hoge Raad der Nederlanden (Netherlands) for a preliminary ruling in the proceedings pending before that court between

F. W. L. de Groot

and

Staatssecretaris van Financiën,

on the interpretation of Article 48 of the EC Treaty (now, after amendment, Article 39 EC) and Article 7 of Regulation (EEC) No 1612/68 of the Council of 15 October 1968 on freedom of movement for workers within the Community (OJ, English Special Edition 1968 (II), p. 475),

* Language of the case: Dutch.

THE COURT (Fifth Chamber),

composed of: M. Wathelet (Rapporteur), President of the Chamber, C.W.A. Timmermans, D.A.O. Edward, P. Jann and A. Rosas, Judges,

Advocate General: P. Léger,

Registrar: M.-F. Contet, Administrator,

after considering the written observations submitted on behalf of:

— the Netherlands Government, by V.J.M. Koningsberger, acting as Agent,

— the Belgian Government, by C. Pochet, acting as Agent,

— the German Government, by W.-D. Plessing and B. Muttelsee-Schön, acting as Agents,

— the Commission of the European Communities, by H. Michard and H.M.H. Speyart, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Mr de Groot, represented by R. van der Jagt, advocaat, the Netherlands Government, represented by H.G. Sevenster, acting as Agent, and the Commission, represented by H. Michard and H.M.H. Speyart, at the hearing on 18 April 2002,

after hearing the Opinion of the Advocate General at the sitting on 20 June 2002,

gives the following

Judgment

1 By order of 18 October 2000, received at the Court on 20 October 2000, the Hoge Raad der Nederlanden (Supreme Court of the Netherlands) referred to the Court for a preliminary ruling under Article 234 EC two questions on the interpretation of Article 48 of the EC Treaty (now, after amendment, Article 39 EC) and Article 7 of Regulation No 1612/68 of the Council of 15 October 1968 on freedom of movement for workers within the Community (OJ, English Special Edition 1968 (II), p. 475).

2 The questions were raised in proceedings between Mr de Groot, a Netherlands national who had employment in various Member States, and the Staatssecretaris van Financiën concerning the calculation of the income tax for 1994 to which he was subject in his State of residence.

Legal framework

The Community provisions

3 Article 48(1) and (2) of the Treaty provides that '[f]reedom of movement for workers shall be secured within the Community' and 'shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment'.

4 Article 7(1) and (2) of Regulation No 1612/68 provides:

'1. A worker who is a national of a Member State may not, in the territory of another Member State, be treated differently from national workers by reason of his nationality in respect of any conditions of employment and work, in particular as regards remuneration, dismissal, and, should he become unemployed, reinstatement or re-employment.

2. He shall enjoy the same social and tax advantages as national workers.'

The other legal provisions applicable in the main proceedings

The conventions

5 The Kingdom of the Netherlands has concluded bilateral conventions for the avoidance of double taxation with the Federal Republic of Germany, the French Republic and the United Kingdom of Great Britain and Northern Ireland ('the bilateral conventions') based on a model convention drawn up by the Organisation for Economic Cooperation and Development (OECD).

6 Those conventions are:

— the Convention between the Kingdom of the Netherlands and the Federal Republic of Germany for the avoidance of double taxation in the field of taxes on income and capital as well as various other taxes and for the settlement of other matters in the field of taxation, signed at The Hague on 16 June 1959 (*Tractatenblad* 1959, 85), as subsequently amended (*Tractatenblad* 1960, 107; 1980, 61 and 200; 1991, 95; 1992, 14; and 1994, 81) ('the Convention with Germany');

— the Convention between the Kingdom of the Netherlands and the French Republic for the avoidance of double taxation and the prevention of tax evasion with regard to taxes on income and capital, signed in Paris on 16 March 1973 (*Tractatenblad* 1973, 83), as subsequently amended (*Tractatenblad* 1974, 41) ('the Convention with France');

— the Convention between the Kingdom of the Netherlands and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains, signed at The Hague on 17 November 1980 (*Tractatenblad* 1980, 205), as subsequently amended (*Tractatenblad* 1981, 54 and 108; 1983, 128; 1989, 128; and 1991, 12 to 14) ('the Convention with the United Kingdom').

7 Under Article 15(1) of the Convention with the United Kingdom, remuneration derived by a resident of the Netherlands in respect of an employment is taxable in the United Kingdom if the employment is exercised there.

8 In order to avoid double taxation, the Kingdom of the Netherlands is required, under Article 22(2)(b) of that convention, to exempt income which may be taxed in the United Kingdom by granting a reduction of the Netherlands tax calculated in accordance with the provisions of national law on the avoidance of double taxation.

9 In the same way, the Conventions with Germany and France state, in Articles 10 and 15 respectively, that income not derived in the State of residence is to be taxed at source in the State of employment. Consequently, income derived and already taxed in Germany or in France is exempt from income tax in the Netherlands in order to avoid double taxation.

10 In addition, in the Conventions with Germany (Article 20(3)) and France (Article 24 Part A(2)) the reduction to avoid double taxation in respect of income which a resident of the Netherlands derives from employment in those States is regulated in a way similar in effect to that which applies as between the Netherlands and the United Kingdom.

11 In contrast to the Convention with the United Kingdom, which expressly refers to the unilateral Netherlands rules on the avoidance of double taxation and to national law on the calculation of the tax reduction, the Conventions with Germany and France contain no such reference and directly provide for the application of the proportionality factor in calculating the tax reduction in the Netherlands. The factor, which is explained in detail in paragraph 18 of this judgment, is represented by a fraction, of which the foreign gross income is the numerator and the total gross income is the denominator.

12 Moreover, under the bilateral arrangements with the Federal Republic of Germany (Article 20(3) of the Convention with Germany), the Republic of France (Article 24 Part A(1) of the Convention with France) and the United Kingdom (Article 22(2)(a) and (b) of the Convention with the United Kingdom), the Kingdom of the Netherlands applies the method of exemption subject to progressivity explained in Article 23A(1) and (3) of the Model Convention of the OECD.

13 Thus, where Netherlands taxpayers residing in the Netherlands receive income in one or more of those other Member States, the Kingdom of the Netherlands refrains from charging tax on the income which has been taxed in that or those other Member States but reserves the right to take that exempt income into account when fixing the progressive rate of that tax.

National law

14 In the Netherlands, direct taxation of natural persons was governed at the time of the facts at issue in the main proceedings by the Wet op de inkomstenbelasting (Income Tax Law) of 16 December 1964 (*Staatsblad* 1964, No 519, 'the Income Tax Law'), as last amended by the Law of 24 December 1993 (*Staatsblad* 1993, No 760), and by the Wet op de loonbelasting (Law on Wages, Salaries and Pensions Tax) of 18 December 1964 (*Staatsblad* 1964, No 521).

15 In addition, the national rules on the avoidance of double taxation were contained at the material time in the Besluit voorkoming dubbele belasting (Decree on the Avoidance of Double Taxation) of 21 December 1989 (*Staatsblad* 1989, No 594), which entered into force on 1 January 1990, in the version resulting from the Royal Decree of 23 December 1994 (*Staatsblad* 1994, No 964) ('the 1989 Decree'), which entered into force on 1 January 1995.

Rules and procedures for the avoidance of double taxation

16 Article 2(2)(b) of the 1989 Decree provides that the foreign gross income consists of the sum total of the gross income received by the taxpayer abroad, that is to say:

'... any gains not to be regarded as profit from foreign business activities... from:

1. work, in so far such income is received in respect of work which is being or has been performed in a private-law employment relationship in the territory of another State'.

17 At the time of the facts at issue in the main proceedings, Article 3 of the 1989 Decree provided as follows:

'1. The exemption is applied by granting a reduction equivalent to the amount of income tax which would be due [under the Income Tax Law] without the application of [a convention for the avoidance of double taxation]. That reduction is equal to the amount which is in the same proportion to the tax which would be payable [under the Income Tax Law] as the foreign gross income is to the gross income, taking into account the reductions and increases provided for in Chapter II, sections 5A, 5B, 5C and 7 of that law and reduced by the losses to be offset on the basis of Chapter IV of that law...'.

18 It follows that the reduction of income tax to be granted in order to avoid double taxation is computed by multiplying the tax on total income by the 'proportionality factor'. The factor is represented by a fraction, in which the numerator is the foreign gross income and the denominator the total gross income.

19 It should be noted that the 1989 Decree contains, in principle, the rules which are to be applied by the tax authorities of the Kingdom of the Netherlands in the absence of a bilateral convention. However, the rules laid down by it are applicable to the case in the main proceedings because the Convention with the United Kingdom provides that the exemption granted by the authorities to avoid double taxation must be calculated in accordance with the provisions of Netherlands law on the avoidance of double taxation, that is, the 1989 Decree, which provides for the proportionality factor, and because the Conventions with Germany and France likewise provide for the application of such a factor in bilateral arrangements with the Kingdom of the Netherlands.

Calculation of tax

20 In the case of a taxpayer residing in the Netherlands, the tax payable under the Income Tax Law is calculated as follows.

21 Where, like Mr de Groot, the resident taxpayer earns his income partly in the Netherlands and partly in another Member State, the tax is first calculated using the generally applicable progressive rate on the basis of overall income, including exempt foreign income, from which are deducted the amounts paid under maintenance obligations and the tax-free allowance to which the taxpayer is entitled as a result of his personal or family circumstances.

22 The relief to be granted for income received and taxed in the various States of employment is deducted from that theoretical amount.

23 In order to calculate the relief which the taxpayer concerned may claim, the tax on total income is multiplied by the proportionality factor.

24 Maintenance payments made by the taxpayer and his tax-free income, which are taken into account in calculating the tax on total income, are not deducted from the total gross income which appears as the denominator in the factor.

25 According to the Explanatory Memorandum on the Decree of 7 November 1991 amending the 1989 Decree:

'This formula has been chosen in order to take account of certain deductions which, in the opinion of the Netherlands legislature, affect tax capacity but are not attributable to specific sources of income either in the Netherlands or abroad. Because those deductions are not connected with specific sources, it can be assumed that those expenses must be defrayed from the income as a whole. By taking the gross income as the denominator in the proportionality factor and multiplying by that factor the total amount of tax which would be payable if this decree were not applied, it is ensured that such expenses are charged proportionally against the foreign part of the income and against that part of the income which is taxable in the Netherlands (a procedure known as apportionment).'

26 The aim of the rules governing the calculation of the exemption is to distribute the allowances relating to a taxpayer's personal and family circumstances over his total income. It follows that those allowances are deducted from the tax payable in the Netherlands only in proportion to the income received by the taxpayer in that Member State.

The main proceedings and the questions referred for a preliminary ruling

27 In 1994 Mr de Groot was a resident of the Netherlands. Until 1 April 1994 he was employed in the Netherlands and in other Member States by companies established in the Netherlands, Germany, France and the United Kingdom belonging to the Applied Materials group. His contract of employment with those companies ended on 1 April 1994. In 1994 he received from the Netherlands company income amounting to NLG 89 665, from the German company income amounting to NLG 74 395, from the French company income amounting to NLG 84 812 and from the United Kingdom company income amounting to NLG 35 009.

28 From 1 April 1994 to 29 October 1995 Mr de Groot was unemployed. From 1 April to 31 December 1994, he received a total of NLG 34 743 in sickness and unemployment benefit in the Netherlands.

29 When his marriage was dissolved in 1987, Mr de Groot was obliged to make maintenance payments. On 26 December 1994 he discharged that obligation by paying NLG 135 000. During that year, he had already made regular maintenance payments totalling NLG 43 230.

30 On the income he received in 1994 on account of his employment with the foreign companies Mr de Groot paid foreign income tax amounting to the equivalent of NLG 16 768 in Germany, NLG 12 398 in France and NLG 11 335 in the United Kingdom. Those taxes were calculated in the various Member States without the maintenance payments made by Mr de Groot in 1994 being taken into account.

31 In his Netherlands tax return for 1994 Mr de Groot applied, with reference to the avoidance of double taxation, for a tax reduction amounting to NLG 187 348, equal to the total foreign income received of NLG 193 816 minus a proportional part of his occupational expenses amounting to NLG 6 468.

32 The tax inspector calculated that reduction in accordance with the proportional method defined in Article 3 of the 1989 Decree and in the Conventions with Germany and France, that is to say by applying the proportionality factor. As a result Mr de Groot was required by him to pay a certain amount in income tax and social security contributions for the 1994 financial year.

33 Considering that the reduction of that amount, obtained after repeated requests, was insufficient, Mr de Groot challenged the tax inspector's decision on that reduction before the Gerechtshof te Amsterdam (Regional Court of Appeal, Amsterdam). He claimed that the use of the proportionality factor method placed him at a tax disadvantage and, in his case, led to a restriction of the freedom of movement for workers prohibited by Article 48 of the Treaty, or of the freedom of establishment, since the result of that method was that he forfeited part of the tax relief to which he should have been entitled on account of his personal circumstances.

34 The Gerechtshof te Amsterdam conceded that a disadvantage for taxpayers residing in the Netherlands who had worked in another Member State did indeed arise. However, it took the view that it was not a case of a restriction prohibited by Article 48 of the Treaty but, rather, of the unfavourable consequences of disparities between the national income tax systems of the Member States concerned. It relied in that respect on Case C-336/96 *Gilly* [1998] ECR I-2793.

35 Mr de Groot lodged an appeal in cassation against that ruling at the Hoge Raad der Nederlanden.

36 That court described the consequences of the application of the proportionality factor for Mr de Groot as follows:

'The effect of the application of the [contested national] provisions was that no allowance was made in... the proportionality factor for the personal liabilities which he incurred in 1994, namely the maintenance payments totalling NLG 178 230, which should have been taken into account as such, even though they did in fact lower the amount of the tax to which the factor is applied. The same is true of the tax-free allowance. Those personal allowances therefore had no effect

on the reduction to avoid double taxation. As a consequence of that, a portion, commensurate with the proportionality factor, of the amount of those allowances did not result in effective reduction of the Netherlands tax payable. Since his personal liabilities and personal and family circumstances were not taken into account, even in part, in the levying of foreign tax, he received less tax relief on account of personal liabilities borne by him, and was able to take less advantage of the tax-free allowance, than would have been the case if he had derived his total earned income in 1994 from one or more employments exercised only in the Netherlands.'

37 The Advocate General at the Hoge Raad der Nederlanden estimated the extent of that disadvantage as follows:

'As a result of the proportional attribution to the foreign part of the income, he loses 187/309ths (or more than 60%) of the tax reduction to which he is entitled in order to avoid double taxation.'

38 The Advocate General at the Hoge Raad der Nederlanden also stated:

'The disadvantage of the "disappearance" of 60% of his tax reduction is compensated for by an advantage: he derives income in three source States, none of which takes into account the income derived outside its territory in order to calculate the tax progression. As a result, he enjoys a significant advantage as regards progressivity. If the three source States concerned were, like the State of residence, to take account of the amount of total income when determining the rate of income tax to be levied by the source State, he would, given the level of his

total income in 1994 (even after deduction of his personal allowances), fall within higher tax bands in the three source States and would therefore pay more tax. It is at present unusual for a source State to require taxpayers abroad to declare their total income in order to reserve a right to apply a progressivity clause, like the State of residence, and to require a declaration of personal circumstances in order to take account thereof proportionally like the State of residence.'

39 Unlike the Gerechtshof te Amsterdam, the Hoge Raad der Nederlanden takes the view that the judgment in *Gilly*, cited above, does not altogether dispel doubt as to whether the disadvantage suffered by Mr de Groot constitutes a restriction prohibited by Article 48 of the Treaty.

40 It concedes that the Court held, in paragraph 49 of the judgment in *Gilly*, that the disparity resulting from the fact that the taxpayer's personal and family circumstances are taken into account in the State of residence but not in the State of employment derives from the fact that the situations of residents and of non-residents are not, as a rule, comparable.

41 However, it considers that that finding in *Gilly* was made in the context of the Court's rejection of the argument that the amount of tax calculated in the State of residence ought to have been the same as that paid in the State of employment.

42 In the main proceedings, Mr de Groot challenges the different treatment by the Kingdom of the Netherlands of taxpayers who are resident in that State as regards the way in which account is taken of their personal liabilities and their personal and family circumstances, depending on whether they earn their income

wholly in the State of residence, or partly in the State of residence and partly in another Member State. The Hoge Raad observes that such a difference may lead to a higher tax burden for the last-mentioned category of taxpayers even where the State of residence and the State of employment operate the same system of taxation and apply identical rates.

43 The Hoge Raad is therefore uncertain whether the method applied in the Netherlands of deducting from foreign income a part of the allowable deductions proportionate to the share of that income in the total income is compatible with Article 48 of the Treaty. It considers that that would be justified if it could be assumed that the legislation of the source country (the State of employment) granted the taxpayer concerned, in proportion to the share of the income earned in that Member State in the total income, the same tax advantages relating to personal circumstances as are granted to the residents of that State. However, the Hoge Raad notes that none of the Member States in which Mr de Groot worked outside the Netherlands grants such advantages.

44 The Hoge Raad considers that the judgments in Case C-279/93 *Schumacker* [1995] ECR I-225 and Case C-391/97 *Gschwind* [1999] ECR I-5451 also indicate that those Member States are not obliged to grant such advantages since the income derived by Mr de Groot outside his State of residence in 1994 did not constitute the whole or practically the whole of his family income.

45 The Hoge Raad also considers that it cannot be inferred from those judgments that, if the amount of tax payable in the State of residence is sufficient for that purpose, the State of residence is bound, regardless of any obstacles arising from the system for taking account of personal and family circumstances adopted by it alone or with another State under a bilateral convention on the avoidance of double taxation, to grant the taxpayer concerned an effective deduction on account of his personal and family circumstances as great as that which he would have been entitled to claim had he earned his whole income in the State of residence.

46 Considering it necessary in those circumstances to refer questions on the conformity of the Netherlands tax law on the avoidance of double taxation with Community law, the Hoge Raad decided to stay proceedings and refer the following questions to the Court of Justice for a preliminary ruling:

'1. Do Article 48 of the EC Treaty... and Article 7 of Regulation (EEC) No 1612/68 of the Council preclude a system for the avoidance of double taxation under which a resident of a Member State, who in a given year (also) derives income in another Member State from employment there, on which he is taxed in that other Member State without account being taken of the employee's personal and family circumstances, loses in his State of residence a proportional part of the advantage of his tax-free allowance and personal tax advantages?

2. If Question 1 is answered in the affirmative, do specific requirements arise from Community law with regard to the manner in which the personal and family circumstances of the employee must be taken into account in his State of residence?'

The first question

47 By its first question, the national court asks in effect whether Article 48 of the Treaty and Article 7 of Regulation No 1612/68 preclude rules such as those at issue in the main proceedings — irrespective of whether or not they are laid down in a convention for the avoidance of double taxation — under which a taxpayer loses in the calculation of the income tax payable by him in his State of

residence part of the benefit of the tax-free allowance and of his personal tax advantages because, during the year in question, he also received income in another Member State which was taxed in that State without his personal and family circumstances being taken into account.

Observations submitted to the Court

48 Mr de Groot observes, first of all, that in paragraph 13 of the judgment in Case 143/87 *Stanton* [1988] ECR 3877 the Court ruled that the provisions of the EC Treaty relating to the free movement of persons are intended to facilitate the pursuit by Community citizens of occupational activities of all kinds throughout the Community, and preclude national legislation which might place Community citizens at a disadvantage when they wish to extend their activities beyond the territory of a single Member State.

49 He goes on to argue that, compared with the situation in which he would have been if he had worked exclusively in the Netherlands where he resides, he enjoys a lesser tax advantage in respect of the allowances relating to his personal circumstances. He therefore considers that he has been placed at a tax disadvantage as a result of the fact that his employment is spread over several Member States.

50 Consequently, he considers that the method applied in the Netherlands to avoid double taxation, whereby the proportionality factor is used when taking account of allowances relating to personal and family circumstances, constitutes an obstacle to the free movement of workers. Contrary to the situation in *Gilly*, that obstacle is not linked to the difference in the tax rates of the Member States. It is also not a result of the Conventions with Germany, France and the United Kingdom but, rather, of the way in which the Kingdom of the Netherlands has

implemented those conventions. The Treaty provisions on the free movement of persons are therefore applicable to a situation such as his.

51 Finally, Mr de Groot submits that it is for the State of residence and not the State of employment to grant personal tax advantages.

52 According to the Netherlands and Belgian Governments, Article 48 does not preclude the application of provisions such as those laid down in the bilateral conventions and the Netherlands legislation.

53 The Netherlands Government concedes that taxpayers in Mr de Groot's situation suffer a disadvantage as a result of the application of the proportionality factor. However, it submits that reliance on Community law as against the Member State of residence cannot eliminate that disadvantage. The disadvantage does not result from the national law on the avoidance of double taxation but rather, for the most part, from the distribution of tax jurisdiction between the Member States on the basis of a convention for the avoidance of double taxation — which does not fall within the scope of the Treaty provisions — and from the fact that the Member States of employment do not grant allowances relating to personal and family circumstances, which is not, in itself, contrary to the Treaty.

54 The Netherlands Government contends further that the way in which the Netherlands tax authorities took account of Mr de Groot's personal and family circumstances is in accordance with the judgment in *Schumacker*, cited above. In that judgment, the Court ruled that it is in principle for the State of residence to take account of the personal and family circumstances of the taxpayer on a

sufficient taxable basis. There is an exception to that principle where the non-resident taxpayer derives the main part of his income and practically the whole income of the tax household in the State of employment.

55 The Netherlands authorities applied that principle since, on the basis of the Conventions with Germany, France and the United Kingdom, which confer tax competence on the Kingdom of the Netherlands, that State, as the State of residence, took into account the personal and family circumstances of the taxpayer in determining the Netherlands tax base. Mr de Groot's personal allowances were thus deducted in full from the total income taxable in the Netherlands, in accordance with the Netherlands legislation.

56 The effects contested by Mr de Groot are therefore produced not as a result of the application of the national tax provisions but solely as a result of the application of the method of avoiding double taxation put in place by the bilateral conventions. Thus, it is when applying in the Netherlands the method of exemption with progression and calculating the tax reduction that certain personal allowances are deducted in proportion to the income exempt from tax in that Member State.

57 If, then, those allowances cannot be deducted in the State or States of employment from the tax levied on the income received in those States, that is the result of the differences between the tax systems of the Member States, the existence of which is not, according to the judgment in *Gilly*, contrary to Community law.

58 The Netherlands Government therefore contends that the attribution by the State of residence of personal allowances in proportion to the exempt income is not contrary to Article 48 of the Treaty.

59 The sole means of remedying a disadvantage such as that suffered by a taxpayer in Mr de Groot's situation, it maintains, is for the State or States of employment to grant the allowances relating to the taxpayer's personal and family circumstances in proportion to the income derived in those States. However, Community law does not, as yet, require the State of employment to do so where the taxpayer concerned does not earn practically the whole of the cumulated income of his tax household in its territory. Only in that specific case would the State of employment be required, in accordance with *Schumacker*, to grant those personal allowances. Moreover, the Kingdom of the Netherlands (as the State of employment, however, and not as the State of residence) introduced that system into its tax law in January 2001.

60 Furthermore, since the allowances cannot be attributed to any particular source of income, they must be distributed across the whole of the income, which means that the State of residence is justified in taking them into account only in proportion to the income derived in its territory.

61 The Belgian Government observes that taxpayers exercising their right to free movement often enjoy a considerable tax advantage, namely the 'salary split' mechanism. Workers who, like Mr de Groot, are taxed in each State of employment only on part of their income are at an advantage as regards income tax progression.

62 The tax advantage which non-resident workers thus enjoy over resident workers as a result of the lack of tax progression is contrary to the principle of tax equity, which requires that taxpayers be taxed in accordance with their ability to pay. According to the Belgian Government, a non-resident worker will always pay less tax than a resident worker on the same income.

63 The Belgian Government adds that the allegation of discrimination, inasmuch as residents of the Netherlands are treated differently depending on whether they receive their income in the Netherlands or abroad, fails to take account of the situation in the State of employment. The problem raised must be resolved in the State of employment and not in the State of residence. The former ought to be able to tax non-residents on the basis of their total income and to grant tax advantages relating to the taxpayer's personal and family circumstances in proportion to the income derived in its territory.

64 The case-law established by the judgments in *Schumacker* and *Gschwind*, cited above, does not permit the State of employment to grant any tax advantage relating to the taxpayer's personal and family circumstances. Accordingly, to require the State of residence to grant all the tax advantages relating to those circumstances solely on the national share of the income would mean that that State would have to bear the entire burden of those tax advantages. That would be unfair because the State of residence is responsible for the greatest part of the public services performed for the taxpayer and the result would be disproportionate to the aim of Article 48 of the Treaty.

65 Finally, the Belgian Government submits that to require the State of residence to grant, solely on the national share of the taxpayer's income, all the tax advantages relating to the taxpayer's personal and family circumstances would promote tax evasion and the adoption of fraudulent schemes to favour the 'salary split' mechanism.

66 The German Government observes that Article 48 of the Treaty may be relied on by a worker as against the Member State of which he is a national and in which he resides where, as in the case in the main proceedings, he exercises his freedom of movement within the Community in order to pursue, in addition to his activity in the State of residence, an economic activity in the territory of another Member State. The German Government takes the view that it is for the State of residence to take into account all the personal and family circumstances of the taxpayer

where that has not been done by the State of employment because the State of residence has all the information necessary to assess the taxpayer's overall ability to pay tax in the light of that situation. In *Schumacker*, the Court held that a non-resident's personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is more easy to assess at the place where his personal and financial interests are centred, which is generally the place where he has his usual abode.

67 The Commission observes that the issue in the main proceedings, namely the attribution of the tax-free allowance and personal tax allowances in proportion to the income taxed abroad, concerns neither the conduct of the States of employment nor the reciprocal legal obligations of the Member States concerned. The dispute relates rather to the way in which the Kingdom of the Netherlands, having undertaken pursuant to a bilateral convention to exempt from Netherlands tax income already taxed abroad, treats that tax-free allowance and the other personal tax allowances which must normally be taken into account.

68 The Commission submits that where a Member State, as State of residence, has elected to exempt amounts already taxed in accordance with a method which may, in some cases, give rise to a progressivity advantage for the taxpayer and where, when taxing non-residents, the States of employment are not — save in the situation illustrated in *Schumacker* — obliged to grant the tax-free allowances and other tax allowances customary under national law, the State of residence must grant the exemption agreed for the purposes of avoiding double taxation. In that case, the State of residence, when taking into account such allowances and other personal tax allowances, cannot draw a distinction between residents who have derived their entire income from employment in its territory and those who have derived part of their income in one or more other Member States.

69 It submits that it is quite clear from the description of the applicable rules and from the findings and calculations made on that basis by the national court and its Advocate General that a person resident for tax purposes in the Netherlands who derives part of his income in another Member State loses a proportional part of his tax-free allowance and other personal tax allowances.

70 The Commission points out that the opinion of the Advocate General at the Hoge Raad der Nederlanden is based on the premiss that the tax treatment of Netherlands residents who derive part of their income in another Member State entails both advantages and disadvantages. The disadvantage is the cause of the dispute in the main proceedings. The advantage consists in the fact that the States of employment do not take into account the total income when determining the applicable rate of tax and therefore cannot apply progressivity, and in the method of avoiding double taxation chosen by the State of residence. The Commission observes that where, as in the Netherlands, the State of residence avoids double taxation by deducting from the potential tax an amount equivalent to the share of foreign income in the total income, the taxpayer enjoys a progressivity advantage.

71 The Commission argues that the Kingdom of the Netherlands is itself responsible for the progressivity advantage and therefore cannot rely on it to claim that the disadvantage arising from the reduction of the tax-free allowance and personal tax allowances is necessary to compensate for that advantage. Even if in most cases the Netherlands tax system favours a resident for tax purposes who has derived income from employment abroad, the fact remains that where that system places such a resident at a disadvantage it constitutes different treatment as compared with a resident for tax purposes who works exclusively in the Netherlands, and thus creates an obstacle to the freedom of movement for workers guaranteed by Article 48 of the Treaty.

72 The Commission considers that that obstacle to freedom of movement for workers cannot be justified by arguments relating to the cohesion of the Netherlands tax system or by the aim of simplifying and coordinating the collection of income tax or by technical difficulties.

73 As regards tax cohesion, the Commission submits that in the main proceedings there is no direct link between a given tax and the corresponding exemption, the existence of which is required by the Court's case-law in the case of the same taxpayer. The exemptions in question, namely the tax-free allowance and any personal allowances, have their own rationale and are not intended to form part of a larger context in which they run counter to a tax relating to the same transaction. Moreover, there is no link between the progressivity advantage and the disadvantage caused by the reduction of the tax-free allowance and any personal allowances.

74 As regards the other two justifications which might be relied upon, the Commission argues that they can in no way justify undermining the rights which individuals derive from the Treaty provisions in which the fundamental freedoms are enshrined (Case C-18/95 *Terhoeve* [1999] ECR I-345, paragraphs 44 and 45).

Findings of the Court

75 The Court observes first of all that, although direct taxation falls within the competence of the Member States, the latter must none the less exercise that competence in accordance with Community law and therefore avoid any overt or covert discrimination on the basis of nationality (*Schumacker*, paragraphs 21 and 26, and *Gschwind*, paragraph 20).

76 Any Community national who, irrespective of his place of residence and his nationality, has exercised the right to freedom of movement for workers and who has been employed in a Member State other than that of residence falls within the scope of Article 48 of the Treaty and Article 7 of Regulation No 1612/68 (Case C-419/92 *Scholz* [1994] ECR I-505, paragraph 9, and *Terhoeve*, cited above, paragraph 27).

77 Moreover, it is settled case-law that all of the Treaty provisions relating to the freedom of movement for persons are intended to facilitate the pursuit by Community nationals of occupational activities of all kinds throughout the Community, and preclude measures which might place Community nationals at a disadvantage when they wish to pursue an economic activity in the territory of another Member State (Case C-370/90 *Singh* [1992] ECR I-4265, paragraph 16, *Terhoeve*, paragraph 37, Case C-190/98 *Graf* [2000] ECR I-493, paragraph 21, and Case C-302/98 *Sehrer* [2000] ECR I-4585, paragraph 32).

78 Provisions which preclude or deter a national of a Member State from leaving his country of origin to exercise his right to freedom of movement therefore constitute an obstacle to that freedom even if they apply without regard to the nationality of the workers concerned (Case C-10/90 *Masgio* [1991] ECR I-1119, paragraphs 18 and 19, and *Terhoeve*, paragraph 39, and *Sehrer*, cited above, paragraph 33).

79 Thus, even if, according to their wording, the rules on freedom of movement for workers are intended, in particular, to secure the benefit of national treatment in the host State, they also preclude the State of origin from obstructing the freedom of one of its nationals to accept and pursue employment in another Member State (see, to that effect, *Terhoeve*, paragraphs 27 to 29).

80 Consequently, the fact that Mr de Groot has Netherlands nationality cannot prevent him from relying on the rules relating to freedom of movement for workers as against the Member State of which he is a national, since he has exercised his right to freedom of movement and worked in another Member State (*Terhoeve*, paragraphs 27 to 29, and *Sehrer*, paragraph 29).

Whether there is an obstacle to freedom of movement for workers

81 It must be noted first that in the main proceedings Mr de Groot, a Netherlands national, resides in the Netherlands and received part of his income for 1994 in that State. The other part of his salary for that year was paid by foreign companies for work done in three other Member States. It is therefore undisputed that he exercised his right to freedom of movement for workers.

82 The fact that Mr de Groot was no longer in an employment relationship at the time of the taxation cannot deprive him of certain guaranteed rights which are linked to the status of worker (see, to that effect, *Sehrer*, paragraph 30, and the case-law cited), since the dispute in the main proceedings is concerned with the direct tax consequences of Mr de Groot's pursuit, as a worker, of activities in other Member States.

83 Secondly, it is clear that the parties to the main proceedings are agreed that, due to the application of the proportionality factor, a portion of the personal tax relief to which Mr de Groot was entitled did not give rise to an actual tax reduction in the Netherlands. He therefore suffered a real disadvantage as a result of the application of the proportionality factor since he derived from his

maintenance payments and from the tax-free allowance a lesser tax advantage than he would have received had he received his entire income for 1994 in the Netherlands.

84 That disadvantage caused by the application by the Member State of residence of its rules on the avoidance of double taxation is liable to discourage a national of that State from leaving it in order to take up paid employment, within the meaning of the Treaty, in the territory of another Member State.

85 Contrary to what the Netherlands Government maintains when it relies on *Gilly*, the disadvantage suffered by Mr de Groot is attributable neither to the disparities between the tax systems of the Member States of residence and employment nor to the tax systems of the various States in which Mr de Groot was employed.

86 In that regard, it should be noted that a situation such as that at issue in the main proceedings can be distinguished from that with which the *Gilly* case was concerned. The tax disadvantage suffered by Mr de Groot is in no way, as the national court suggested, the result of the difference between the tax rates of the State of residence and those of the States of employment; the Court ruled however, in paragraph 47 of the judgment in *Gilly*, that the unfavourable consequences which the tax credit mechanism in question might entail for Mrs Gilly were the result primarily of the differences between the tax scales of the Member States concerned, and that, in the absence of any Community legislation in the field, the determination of those scales was a matter for those Member States.

87 Moreover, while Mrs Gilly obtained in her State of residence all the tax advantages provided for for its residents by the legislation of that State, that is not the case with respect to Mr de Groot, whose claim in the main proceedings is precisely that he was deprived in his State of residence of part of the reductions provided for for residents of that State by its legislation because he exercised his right to freedom of movement.

88 As regards the failure by the tax regimes in the States of employment to take into account Mr de Groot's personal and family circumstances, as indicated in the order for reference, it must be noted, as the Commission rightly did, that there is no provision for such an obligation in the Conventions with Germany, France and the United Kingdom.

89 Moreover, the Court ruled, in paragraphs 36 and 27 respectively of the judgments in *Schumacker* and *Gschwind*, that the Member State of employment is required to take into account personal and family circumstances only where the taxpayer derives almost all or all of his taxable income from employment in that State and where he has no significant income in his State of residence, so that the latter is not in a position to grant him the advantages resulting from taking account of his personal and family circumstances.

90 In paragraph 32 of the *Schumacker* judgment, the Court also ruled that it is a matter for the State of residence, in principle, to grant the taxpayer all the tax allowances relating to his personal and family circumstances because that State is best placed to assess the taxpayer's personal ability to pay tax, since that is where his personal and financial interests are centred.

91 In this case, even if, as the Netherlands Government claims, the maintenance payments made by Mr de Groot and the tax-free allowance were taken into account in calculating the theoretical amount of tax payable on his total income, it is plain that, as a result of the application of the proportionality factor, Mr de Groot benefited from the allowances relating to his personal and family circumstances only in proportion to the income which he had received in the Netherlands. Thus, as a consequence of his exercise of his right to freedom of movement, he forfeited part of the tax allowances provided for by Netherlands law to which he was entitled as a resident of the Netherlands.

92 It should be added that it is irrelevant that the proportionality factor was applied in accordance with the 1989 Decree, in relation to the income derived and taxed in the United Kingdom, or with the provisions of the Conventions with Germany and France, in relation to the income derived and taxed in those Member States, even if those conventions merely reflect the provisions of Netherlands law on that matter.

93 It is settled case-law that in the absence of unifying or harmonising measures adopted in the Community the Member States remain competent to determine the criteria for taxation of income and capital with a view to eliminating double taxation by means, *inter alia*, of international agreements. In that context, the Member States are at liberty, in the framework of bilateral agreements, to determine the connecting factors for the purposes of allocating powers of taxation (*Gilly*, paragraphs 24 and 30, and Case C-307/97 *Saint-Gobain* [1999] ECR I-6161, paragraph 57).

94 However, as far as the exercise of the power of taxation so allocated is concerned, the Member States must comply with the Community rules (see, to that effect, *Saint-Gobain*, cited above, paragraph 58) and, more particularly, respect the principle of national treatment of nationals of other Member States and of their own nationals who exercise the freedoms guaranteed by the Treaty.

95 Rules such as those at issue in the main proceedings therefore constitute an obstacle to freedom of movement for workers which is, in principle, prohibited by Article 48 of the Treaty.

Whether such an obstacle is justified

96 It must be considered, however, whether such an obstacle can be justified in the light of the provisions of the Treaty.

97 Firstly, with respect to the argument that the disadvantage suffered by a taxpayer such as Mr de Groot in relation to the reduction of tax is to a large extent compensated for by a progressivity advantage, described by the Advocate General at the national court and referred to by the Belgian Government, it is sufficient to state that it is settled case-law that detrimental tax treatment contrary to a fundamental freedom cannot be justified by the existence of other tax advantages, even if those advantages exist (see, with respect to the freedom of establishment, Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 21, Case C-107/94 *Asscher* [1996] ECR I-3089, paragraph 53, and *Saint-Gobain*, paragraph 54; with respect to the freedom to provide services, Case C-294/97 *Eurowings Luftverkehr* [1999] ECR I-7447, paragraph 44; and, with respect to the free movement of capital, Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 61).

98 Secondly, it is necessary to reject the argument of the Netherlands Government that it is legitimate for the State of residence to take into account the personal and family circumstances of a resident taxpayer only in proportion to the income derived in its territory since it is for the State of employment to do the same with respect to the share of income taxable in its territory. In that respect, it should be observed that income received in the territory of a Member State by a non-resident worker is in most cases only a part of his total income, which is concentrated at his place of residence. Moreover, a non-resident's personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is more easy to assess at the place where his personal and

financial interests are centred. In general, that is the place where he has his usual abode. International tax law, and in particular the Model Double Taxation Convention of the OECD, also recognises that, in principle, the overall taxation of taxpayers, taking account of their personal and family circumstances, is a matter for the State of residence (see *Schumacker*, paragraph 32).

99 The Member States are of course free, in the absence of unifying or harmonising measures adopted in the Community, to alter, by way of bilateral or multilateral agreements for the avoidance of double taxation, that correlation between the total income of residents and residents' general personal and family circumstances to be taken into account by the State of residence. The State of residence can therefore be released by way of an international agreement from its obligation to take into account in full the personal and family situation of taxpayers residing in its territory who work partially abroad.

100 The State of residence may also be released from that obligation if it finds that, even in the absence of a convention, one or more of the States of employment, with respect to the income taxed by them, grant advantages based on the personal and family circumstances of taxpayers who do not reside in the territory of those States but receive taxable income there.

101 However, the mechanisms used to eliminate double taxation or the national tax systems which have the effect of eliminating or alleviating double taxation must permit the taxpayers in the States concerned to be certain that, as the end result, all their personal and family circumstances will be duly taken into account, irrespective of how those Member States have allocated that obligation amongst themselves, in order not to give rise to inequality of treatment which is incompatible with the Treaty provisions on the freedom of movement for workers and in no way results from the disparities between the national tax laws.

102 In this case, it is clear that Netherlands law and the conventions concluded with Germany, France and the United Kingdom do not ensure that result. The State of residence is partially released from its obligation to take into account the taxpayers' personal and family circumstances without the States of employment undertaking to bear the tax consequences of taking such circumstances into account or having them imposed on them by virtue of the conventions for the avoidance of double taxation concluded with the State of residence. The situation is different only as regards the Convention with Germany, in the sole case that 90% of the income is received in the State of employment, which is not the case in the main proceedings.

103 Thirdly, with respect to the argument put forward by the Belgian Government that it would be disproportionate to place on the State of residence the burden of granting all the allowances which resident taxpayers who have received income in other Member States may claim, even where that income has been taxed in those other Member States without the taxpayer's personal and family circumstances being taken into account, it is settled case-law that a loss of tax revenue can never be relied upon to justify a restriction on the exercise of a fundamental freedom (Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 28, and *Saint-Gobain*, paragraph 51).

104 Moreover, it should be noted that, when taxing Mr de Groot's income, the Netherlands authorities were able to apply progressivity of the national tax rate because a clause reserving the right to tax progression was included in the bilateral conventions.

105 Lastly, it cannot be claimed that the system provided for in the Netherlands legislation and the bilateral conventions permitting deduction of personal allowances in proportion to the tax-free income is necessary to safeguard the cohesion of the method of exemption with progression.

106 Certainly, the Court has held that the need to safeguard the cohesion of a tax system may justify rules that are liable to restrict fundamental freedoms (Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 28, and Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305, paragraph 21).

107 However, that is not the case here.

108 In *Bachmann* and *Commission* v *Belgium* there was a direct link between the deductibility of contributions paid for old-age and life assurance contracts and the taxation of the sums paid out under those contracts, a link which had to be maintained in order to safeguard the cohesion of the tax system in question.

109 However, there is no such direct link in the case in the main proceedings between, on the one hand, the method of exemption with progression, whereby the State of residence forgoes taxing income derived in other Member States but takes it into consideration for the purposes of determining the tax rate applicable to the taxable income, and, on the other hand, permitting deduction of personal allowances only in proportion to the income received in the State of residence. As the Advocate General pointed out in paragraph 58 of his Opinion, the effectiveness of the progressive rates of income tax in the State of residence, which the method of exemption with progression seeks to ensure, is not dependent on the restriction, in that State, of the account to be taken of the taxpayer's personal and family circumstances.

110 The answer to the first question must therefore be that Article 48 of the Treaty precludes rules such as those at issue in the main proceedings — irrespective of whether or not they are laid down in a convention for the avoidance of double taxation — whereby a taxpayer forfeits, in the calculation of the income tax payable by him in his State of residence, part of the tax-free amount of that

income and of his personal tax advantages because, during the year in question, he also received income in another Member State which was taxed in that State without his personal and family circumstances being taken into account.

111 In view of the answer given to the first question with respect to Article 48 of the Treaty, it is unnecessary to consider whether Article 7 of Regulation No 1612/68 precludes rules such as those at issue in the main proceedings.

The second question

112 By its second question, the national court asks in effect whether Community law lays down specific requirements with regard to the way in which the State of residence must take account of the personal and family circumstances of an employee who has worked in another Member State.

113 According to the Commission, where, as in the case in the main proceedings, national legislation or a convention is incompatible with Article 48 of the Treaty, a person resident for tax purposes in a Member State who exercises his right to freedom of movement for workers is entitled to have the allowance relating to his personal and family circumstances fixed at an amount equal to that which he could have claimed if he had derived his total income in the State of residence. Subject to that, there is no specific requirement in Community law with regard to the way in which the State of residence must take account of the personal and family circumstances of the employee concerned.

Findings of the Court

114 Community law lays down no specific requirement with regard to the way in which the State of residence must take account of the personal and family circumstances of a worker who, during a particular tax year, received income in that State and in another Member State. However, as the Advocate General pointed out in paragraph 72 of his Opinion, the conditions governing the way in which the State of residence takes into account such a taxpayer's personal and family circumstances must not constitute discrimination, either direct or indirect, on grounds of nationality, or an obstacle to the exercise of a fundamental freedom guaranteed by the Treaty.

115 The answer to the second question must therefore be that Community law contains no specific requirement with regard to the way in which the State of residence must take into account the personal and family circumstances of a worker who, during a particular tax year, received income in that State and in another Member State, except that the conditions governing the way in which the State of residence takes those circumstances into account must not constitute discrimination, either direct or indirect, on grounds of nationality, or an obstacle to the exercise of a fundamental freedom guaranteed by the Treaty.

Costs

116 The costs incurred by the Netherlands Government, the Belgian Government, the German Government and 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 (Fifth Chamber),

in answer to the questions referred to it by the Hoge Raad der Nederlanden by order of 18 October 2000, hereby rules:

1. **Article 48 of the EC Treaty (now, after amendment, Article 39 EC) precludes rules such as those at issue in the main proceedings — irrespective of whether or not they are laid down in a convention for the avoidance of double taxation — whereby a taxpayer forfeits, in the calculation of the income tax payable by him in his State of residence, part of the tax-free amount of that income and of his personal tax advantages because, during the year in question, he also received income in another Member State which was taxed in that State without his personal and family circumstances being taken into account.**

2. **Community law contains no specific requirement with regard to the way in which the State of residence must take into account the personal and family circumstances of a worker who, during a particular tax year, received income**

in that State and in another Member State, except that the conditions governing the way in which the State of residence takes those circumstances into account must not constitute discrimination, either direct or indirect, on grounds of nationality, or an obstacle to the exercise of a fundamental freedom guaranteed by the EC Treaty.

Wathelet Timmermans Edward

Jann Rosas

Delivered in open court in Luxembourg on 12 December 2002.

R. Grass M. Wathelet

Registrar President of the Fifth Chamber