JUDGMENT OF THE COURT (Fifth Chamber)

13 November 2003 *

In Case C-209/01,

REFERENCE to the Court under Article 234 EC by the Bundesfinanzhof (Germany) for a preliminary ruling in the proceedings pending before that court between

Theodor Schilling,

Angelika Fleck-Schilling

and

Finanzamt Nürnberg-Süd,

on the interpretation of Article 48 of the EC Treaty (now, after amendment, Article 39 EC) and of the first paragraph of Article 14 of the Protocol on the Privileges and Immunities of the European Communities,

* Language of the case: German.

THE COURT (Fifth Chamber),

composed of: D.A.O. Edward, acting for the President of the Fifth Chamber, A. La Pergola and S. von Bahr (Rapporteur), Judges,

Advocate General: A. Tizzano,
Registrar: R. Grass,

after considering the written observations submitted on behalf of:

— Mr Schilling and Mrs Fleck-Schilling, by H. Hacker, Steuerberater,

— the Commission of the European Communities, by J.-F. Pasquier and H. Kreppel, acting as Agents,

having regard to the report of the Judge-Rapporteur,

after hearing the Opinion of the Advocate General at the sitting on 11 November 2003,

gives the following

Judgment

1 By order of 21 February 2001, received at the Court on 21 May 2001, the Bundesfinanzhof (Federal Finance Court) has referred under Article 234 EC four questions on the interpretation of Article 48 of the EC Treaty (now, after amendment, Article 39 EC) and of the first paragraph of Article 14 of the Protocol on the Privileges and Immunities of the European Communities (hereinafter 'the Protocol').

2 Those questions have arisen in a dispute between, on the one hand, Mr Schilling and his wife, Mrs Fleck-Schilling, and, on the other, the Finanzamt Nürnberg-Süd (Tax Office for Nuremberg South) in regard to the tax deductibility in Germany of the expenditure incurred in respect of a household assistant employed and working in Luxembourg.

Legal framework

Community law

3 Article 13 of the Protocol provides:

'Officials and other servants of the Communities shall be liable to a tax for the benefit of the Communities on salaries, wages and emoluments paid to them by the Communities, in accordance with the conditions and procedure laid down by the Council, acting on a proposal from the Commission.

They shall be exempt from national taxes on salaries, wages and emoluments paid by the Communities.'

4 The first and second paragraphs of Article 14 of the Protocol provide as follows:

'In the application of income tax, wealth tax and death duties and in the application of conventions on the avoidance of double taxation concluded between Member States of the Communities, officials and other servants of the Communities who, solely by reason of the performance of their duties in the service of the Communities, establish their residence in the territory of a Member State other than their country of domicile for tax purposes at the time of entering the service of the Communities, shall be considered, both in the country of their actual residence and in the country of domicile for tax purposes, as having maintained their domicile in the latter country provided that it is a member of the Communities. This provision shall also apply to a spouse, to the extent that the latter is not separately engaged in a gainful occupation, and to children dependent on and in the care of the persons referred to in this Article.

Movable property belonging to persons referred to in the preceding paragraph and situated in the territory of the country where they are staying shall be exempt from death duties in that country; such property shall, for the assessment of such duty, be considered as being in the country of domicile for tax purposes, subject to the rights of third countries and to the possible application of provisions of international conventions on double taxation.'

5 Article 48 of the Treaty is worded as follows:

'1. Freedom of movement for workers shall be secured within the Community by the end of the transitional period at the latest.

2. Such freedom of movement 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.

3. It shall entail the right, subject to limitations justified on grounds of public policy, public security or public health:

(a) to accept offers of employment actually made;

(b) to move freely within the territory of Member States for this purpose;

(c) to stay in a Member State for the purpose of employment in accordance with the provisions governing the employment of nationals of that State laid down by law, regulation or administrative action;

(d) to remain in the territory of a Member State after having been employed in that State, subject to conditions which shall be embodied in implementing regulations to be drawn up by the Commission.

4. The provisions of this Article shall not apply to employment in the public service.'

National law

6 Paragraph 1(1) and (4) of the Einkommensteuergesetz (Law on Income Tax) of 7 September 1990 (BGBl. 1990 I, p. 1898, and amendment of 7 March 1991 BGBl. 1991 I, p. 808) (hereinafter 'the EStG') provides:

'Tax liability

1. Natural persons who have their permanent residence or usual abode in Germany are subject there to tax on their total income....

...

4. Natural persons not having their permanent residence or usual abode in Germany are subject to tax only on the part of their income arising in Germany within the meaning of Paragraph 49.'

7 Paragraph 10(1)(8) of the EStG, in the version applicable to the main proceedings, provides as follows:

'Special expenditure

1. Special expenditure corresponds to the following expenditure, on condition that it does not relate to operating costs or professional charges:

...

(8) Expenditure incurred by the taxpayer up to an amount of DEM 12 000 per calendar year in respect of a household assistant, in the case where compulsory contributions are paid, within the framework of the employment relationship, to the national statutory pension insurance scheme....'

8 Paragraph 50(1) of the EStG provides:

'Specific provisions of Paragraph 50 concerning persons subject to partial taxation

1. ... Paragraphs... 10... are not applicable...'.

The dispute in the main proceedings and the questions referred for preliminary ruling

9 During 1991 and 1992, Mr and Mrs Schilling worked as officials of the European Communities in Luxembourg, the Member State in which they were resident and had their centre of interests, and in which their three children, who were born in 1982, 1983 and 1986, also lived. In Germany, the Member State of origin of Mr and Mrs Schilling, Mr Schilling derived income from letting property and, in the 1992 tax year, to a lesser extent from self-employed work.

10 The dispute in the main proceedings centres on the deduction in Germany of expenditure incurred in respect of a household assistant employed in Luxembourg, for whom Mr and Mrs Schilling had paid compulsory contributions to the Luxembourg statutory pension insurance scheme. The Finanzamt Nürnberg-

Süd refused to allow that deduction on the ground that no contribution had been paid to the German statutory pension insurance scheme in accordance with Paragraph 10(1)(8) of the EStG.

11 The administrative complaint and subsequent legal action brought by Mr and Mrs Schilling were dismissed. In their appeal on an issue of law ('Revision') to the Bundesfinanzhof, they argued that Article 14 of the Protocol is intended to maintain the fiscal relationship between an official of the European Communities and his Member State of origin as if he had never left that State. In the case in the main proceedings, that provision makes it possible to proceed as if the compulsory contributions paid to the Luxembourg pension insurance fund had been paid in Germany. Furthermore, they submit, the legal interpretation of the Finanzamt Nürnberg-Süd is at variance with the Community principle of equal treatment.

12 The Bundesfinanzhof finds that, in accordance with Paragraph 10(1)(8) of the EStG, in the version applicable to the case in the main proceedings, expenditure incurred in respect of a household assistant could, up to a maximum limit of DEM 12 000, be deducted as being special expenditure in the case where compulsory contributions had been paid by the employer to the national statutory pension scheme. That deduction was allowed only if the household of the taxable persons included two children who had not yet reached the age of 10 at the beginning of the calendar year. The Bundesfinanzhof points out that, according to the official statement of reasons for the Law (BTDrucks 11/4688, p. 10, in particular at p. 12), the restriction to the national statutory pension insurance scheme was essentially attributable to considerations of economic, social and labour-market policy. According to the Bundesfinanzhof, there was a need, in families with children or persons in need of care, to reduce, particularly for women, the burden and disadvantages of housekeeping, work and caring. The legislature intended by that measure to create additional employment and to counteract the detrimental effect of undeclared employment for both the workers concerned and the national statutory pension insurance scheme.

13 The Bundesfinanzhof takes the view that the scope of the first paragraph of Article 14 of the Protocol is unclear. The fictitious domicile for tax purposes which that provision establishes may serve solely for justifying unlimited tax liability and residence within the meaning of double taxation agreements (see Article 4 of the 1977 model agreement of the Organisation for Economic Cooperation and Development). In contrast, if that provision were to be construed more broadly in the sense advocated by Mr and Mrs Schilling, the fiction could apply to factual situations directly relating to domicile. Payment to the Luxembourg social security institution would then have to be treated as if it had been made to a German social security institution.

14 In the opinion of the Bundesfinanzhof, the first paragraph of Article 14 of the Protocol must be interpreted strictly. This is supported not only by the fact that the Community lacks competence in matters of direct taxation but also by the second paragraph of Article 14 of the Protocol. According to the latter provision, movable property situated in the territory of the State of residence is, for purposes of death duties, to be considered as being in the Member State of origin. There is thus an additional fiction as to the location of the property. The Bundesfinanzhof takes the view that, if the first paragraph of Article 14 of the Protocol had the broad content attributed to it by Mr and Mrs Schilling, the second paragraph of that article would be redundant. It is also necessary, in the Bundesfinanzhof's view, to take account of the fact that there are numerous other provisions in German tax law which give advantages only to national situations. A strict interpretation also appears appropriate in view of the fact that officials of the European Communities already benefit from the comparatively low taxation of their salaries.

15 The Bundesfinanzhof adds that, should the Court conclude that Paragraph 10(1)(8) of the EStG is not contrary to the first paragraph of Article 14 of the Protocol, the question will then arise as to whether that provision of national law complies with Article 48 of the Treaty. According to the Bundesfinanzhof, however, it is necessary to determine whether Article 48(4) of the Treaty is to be construed as meaning that an official of the European Communities cannot rely on that article.

16 The Bundesfinanzhof takes the view that, if the Court should conclude that the national provision in issue in the main proceedings is contrary to Article 48 of the Treaty, the question will then arise as to whether the principles developed in the judgment in Case C-112/91 *Werner* [1993] ECR I-429 may be applied to the case in the main proceedings. The Court ruled in *Werner* that Community law does not preclude a Member State from imposing a heavier tax burden on its nationals who work within its territory if they reside in another Member State. The Bundesfinanzhof entertains doubts as to the relevance of the *Werner* judgment. In that case the only connecting foreign factor was the fact of residence. In the main proceedings in the present case, in contrast, Mr and Mrs Schilling have worked and lived in another Member State. The connecting foreign factor is thus significantly stronger.

17 The Bundesfinanzhof decided in those circumstances to stay the proceedings and to refer the following four questions to the Court for a preliminary ruling:

'1. Is it contrary to the first paragraph of Article 14 of the Protocol on the Privileges and Immunities of the European Communities... if German nationals who work in Luxembourg as officials of the European Community and live there may not, in the context of assessment to German income tax, deduct expenditure in respect of a household assistant employed in Luxembourg under Paragraph 10(1)(8) of the Einkommensteuergesetz because the contributions to the statutory pension insurance scheme for the household assistant were not paid to the German pension insurance scheme?

2. If Question 1 is answered in the negative: Is Article 48(4) of the EC Treaty to be interpreted as meaning that an EC official may not rely on Article 48 of the EC Treaty?

3. If Question 2 is answered in the negative: Is it contrary to Article 48 of the EC Treaty if an EC official living in Luxembourg who is deemed to be resident in Germany and pays contributions in Luxembourg to the statutory pension insurance scheme for a household assistant is not entitled to deduct special expenditure under Paragraph 10(1)(8) of the Einkommensteuergesetz?

4. If Question 3 is answered in the negative: May the principles developed in the judgment in... *Werner*... be applied to the present case?'

The application for the procedure to be reopened

18 By application lodged at the Court Registry on 1 April 2003, Mr and Mrs Schilling requested that the oral procedure or the written procedure be reopened in so far as the Court intended to base its judgment on an argument developed by the Advocate General in point 80 of his Opinion which was not the subject of discussion by the parties. According to that argument, an interpretation of Article 14 of the Protocol along the lines advocated by Mr and Mrs Schilling would have the effect of conferring on them preferential economic treatment without any objective justification whatever.

19 In that regard, it must be recalled that the Court may of its own motion, on a proposal from the Advocate General or at the request of the parties, order that the oral procedure be reopened in accordance with Article 61 of its Rules of Procedure, if it considers that it lacks sufficient information, or that the case must be dealt with on the basis of an argument which has not been debated between the parties (see, inter alia, Case C-299/99 *Philips* [2002] ECR I-5475, paragraph 20, and Case C-184/01 P *Hirschfeldt* v *EEA* [2002] ECR I-10173, paragraph 30).

20 The Court finds that there is no reason in the present case to order a reopening of the oral or written procedure. The application for such reopening must accordingly be rejected.

The questions submitted for preliminary ruling

21 By the four questions which it has submitted, which it is appropriate to examine together, the Bundesfinanzhof is in substance asking whether Community law, in particular Article 48 of the Treaty and Article 14 of the Protocol, precludes a situation in which Community officials of German origin who are resident in Luxembourg and have incurred expenditure in respect of a household assistant in the latter Member State are unable to deduct that expenditure from their taxable income in Germany by reason of the fact that the contributions paid in respect of the household assistant were paid to the Luxembourg statutory pension insurance scheme and not to the German scheme.

22 As a preliminary point, it should be noted 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 must therefore avoid any overt or covert discrimination on the basis of nationality (see, inter alia, Case C-385/00 *De Groot* [2002] ECR I-11819, paragraph 75).

23 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 (*De Groot*, cited above, paragraph 76).

24 It is, moreover, 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; Case C-18/95 *Terhoeve* [1999] ECR I-345, 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).

25 In that regard, provisions which prevent or deter a national of a Member State from leaving his State of origin to exercise his right to freedom of movement constitute an obstacle to that freedom even if they apply without regard to the nationality of the workers concerned (see, inter alia, Case C-232/01 *Van Lent* [2003] ECR I-11525, paragraph 16).

26 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, inter alia, *De Groot*, paragraph 79).

27 Consequently, the fact that Mr and Mrs Schilling are German nationals cannot prevent them from relying on the rules on free movement of workers as against the Member State of which they are nationals, since they have exercised their right to freedom of movement and worked in another Member State (see, to that effect, *De Groot*, paragraph 80).

28 It should also be borne in mind that, according to settled case-law, a Community national working in a Member State other than his State of origin does not lose his status of worker within the meaning of Article 48(1) of the Treaty by virtue of the fact that he occupies a post within an international organisation, even if the rules relating to his entry into and residence in the country in which he is employed are specifically governed by an international agreement (Joined Cases 389/87 and 390/87 *Echternach and Moritz* [1989] ECR 723, paragraph 11; Case C-310/91 *Schmid* [1993] ECR I-3011, paragraph 20; and Case C-411/98 *Ferlini* [2000] ECR I-8081, paragraph 42).

29 It must, however, be pointed out that officials and other servants of the European Communities are subject to special rules in matters of taxation that distinguish them from other workers.

30 Thus, although Mr and Mrs Schilling left their Member State of origin (Germany) in order to work as officials of the European Communities in another Member State (Luxembourg), their salaries as officials are not subject to tax in either of those Member States but are, in accordance with Article 13 of the Protocol, taxed pursuant to the separate taxation system of the European Communities provided for under Regulation (EEC, Euratom, ECSC) No 260/68 of the Council of 29 February 1968 laying down the conditions and procedure for applying the tax for the benefit of the European Communities (OJ English Special Edition 1968 (I), p. 37).

31 In accordance with Article 14 of the Protocol, the Member State of origin, in which the domicile of the official or servant is maintained for tax purposes, remains in principle competent to tax all other income of those persons and to subject that income to wealth tax and death duties. The officials and servants covered by Article 14 of the Protocol are for that reason entitled to apply for the tax deductions that are provided for by the national taxation scheme of the Member State of origin and that are not connected to their salaries as Community officials or servants.

32 It appears to follow from the order for reference that the tax deduction in issue in the main proceedings is not connected to the professional income of taxpayers and that there is therefore no connection with the salaries of officials and other servants of the European Communities covered by Article 13 of the Protocol.

33 It follows that an official of the European Communities who is of German origin and who, while working in another Member State, maintains his habitual residence in his State of origin and employs a household assistant in that State, for whom he pays contributions to that State's statutory pension insurance scheme, is in a position to benefit from the tax deduction in issue in the main proceedings.

34 In contrast, persons in the situation of Mr and Mrs Schilling, who have left their State of origin to work as officials of the European Communities in another Member State, are not normally in a position to benefit from that tax advantage.

35 Such persons, who employ a household assistant in their new State of residence and pay social contributions to the social security system of that State, will only in exceptional circumstances be able to satisfy a condition, such as that in issue in the main proceedings, under which they are required to have paid contributions to the statutory pension insurance scheme of their Member State of origin.

36 Persons in the situation of Mr and Mrs Schilling are therefore treated less favourably than are persons who are in an identical situation but for the fact that they have retained their habitual residence in their State of origin.

37 In those circumstances, it appears that a condition such as that laid down in Paragraph 10(1)(8) of the EStG is liable to deter nationals of one Member State from leaving that State in order to work, as officials of the European Communities, within the territory of another Member State and for that reason constitutes a barrier to the free movement of workers.

38 The possibility of justification for this barrier to the free movement of workers has not been mentioned by the Bundesfinanzhof or by the interested parties which have submitted observations to the Court.

39 It is, however, appropriate to examine whether that barrier may be justified in the light of the Treaty provisions.

40 It should first be noted in this regard that the national legislation in issue in the main proceedings is designed, according to the Bundesfinanzhof, to help large families, to create additional employment, and to combat undeclared employment. It does not appear that those objectives would be jeopardised if the tax advantage in question was also granted to those persons who pay social contributions in another Member State. It ought to be added that, no matter how legitimate the pursuit of those objectives may be, they cannot justify an infringement of the rights derived by individuals from the Treaty provisions which enshrine their fundamental freedoms.

41 Second, it should be noted that 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 (see Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 28; Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305, paragraph 21; and *De Groot*, paragraph 106) if there is a direct link, in the case of one and the same taxpayer, between the grant of a tax advantage and the offsetting of that

advantage by a fiscal levy, both of which relate to the same tax (see Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 57, and Case C-136/00 *Danner* [2002] ECR I-8147, paragraph 36).

42 No link of such a kind appears to exist, in the case in the main proceedings, between the tax advantage, that is to say, the right in question to a deduction, and a specific taxable income.

43 In those circumstances, the barrier to the free movement of workers resulting from Paragraph 10(1)(8) of the EStG cannot be justified on grounds of the need to preserve fiscal coherence.

44 The answer to the questions submitted by the Bundesfinanzhof must therefore be that Article 48 of the Treaty, in conjunction with Article 14 of the Protocol, precludes a situation in which officials of the European Communities who are of German origin and are resident in Luxembourg, where they work as officials, and who have incurred expenditure in respect of a household assistant in the latter Member State cannot deduct that expenditure from their taxable income in Germany by reason of the fact that the contributions paid for the household assistant were made to the Luxembourg statutory pension insurance scheme and not to the German scheme.

Costs

45 The costs incurred by the Commission, which has 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 Bundesfinanzhof by order of 21 February 2001, hereby rules:

Article 48 of the EC Treaty (now, after amendment, Article 39 EC), in conjunction with Article 14 of the Protocol on the Privileges and Immunities of the European Communities, precludes a situation in which officials of the European Communities who are of German origin and are resident in Luxembourg, where they work as officials, and who have incurred expenditure in respect of a household assistant in the latter Member State cannot deduct that expenditure from their taxable income in Germany by reason of the fact that the contributions paid for the household assistant were made to the Luxembourg statutory pension insurance scheme and not to the German scheme.

Edward La Pergola von Bahr

Delivered in open court in Luxembourg on 13 November 2003.

R. Grass V. Skouris

Registrar President