JUDGMENT OF THE COURT (First Chamber)

15 July 2004 *

In Case C-242/03,

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

Ministre des Finances

and

Jean-Claude Weidert,

Élisabeth Paulus,

on the interpretation of Article 56(1) EC and Article 58(1)(a) EC,

* Language of the case: French.

THE COURT (First Chamber),

composed of: P. Jann (Rapporteur), President of the Chamber, A. Rosas and R. Silva de Lapuerta, Judges,

Advocate General: J. Kokott,
Registrar: R. Grass,

after considering the written observations submitted on behalf of:

— Mr Weidert and Ms Paulus, by P. Kinsch, avocat,

— the Luxembourg Government, by S. Schreiner, acting as Agent,

— the Commission of the European Communities, by R. Lyal and C. Giolito, acting as Agents,

having regard to the Report of the Judge-Rapporteur,

after hearing the Opinion of the Advocate General at the sitting on 12 February 2004,

gives the following

Judgment

1 By judgment of 3 June 2003, received at the Court on 6 June 2003, the Cour Administrative (Higher Administrative Court) referred to the Court for a preliminary ruling under Article 234 EC a question on the interpretation of Article 56(1) EC and Article 58(1)(a) EC.

2 That question was raised in proceedings between the Ministre des Finances and Mr Weidert and Mrs Paulus (hereinafter 'Mr and Mrs Weidert-Paulus') arising out of a refusal to grant tax relief to the latter for the acquisition of shares in a company established in Belgium.

Legal framework

3 In Luxembourg law, Article III of the Law of 22 December 1993 to promote investment in the interest of economic development (*Mémorial* A, 1993, p. 2020) inserted in Income Tax Law of 4 December 1967 (*Mémorial* A 1967, p. 1228; 'the Income Tax Law') an Article 129c worded as follows:

'Paragraph 1. In the circumstances and within the limits specified below, resident taxpayers who are natural persons and acquire shares representing cash

contributions in fully-taxable resident capital companies defined in subparagraph 1 of paragraph 2 below shall enjoy the tax advantages laid down in paragraph 4 below.

...

Paragraph 4. (1) The taxpayers referred to in paragraphs 1 and 3 above shall be entitled on request to relief from income tax in the form of relief for investment in personal property, which may, notwithstanding the provisions of Article 153, be claimed where the taxpayer is subject to direct assessment.

(2) The relief shall be subject to a maximum of LUF 60 000 per year in respect of all acquisitions of securities and interests therein held by the taxpayer at the end of the tax year. That limit shall be doubled in the case of joint assessment under Article 3.

Paragraph 5. For the tax advantages set out in paragraph 4 to apply, the following conditions must be satisfied:

(a) the acquisition of the securities within the meaning of subparagraph 2 of paragraph 2 above must have occurred either on the formation, or on an increase of capital for valuable consideration, of a fully-taxable resident capital company, as defined in subparagraph 1 of paragraph 2 above;

...'

4 The Convention for the Avoidance of Double Taxation concluded between the Kingdom of Belgium and the Grand Duchy of Luxembourg, signed at Luxembourg on 17 September 1970 (*Mémorial* A 1971, p. 1763) ('the Double Taxation Convention') provides:

'Article 10 Dividends:

(1) Dividends declared by a company having its seat in a Contracting State in favour of a resident of the other Contracting State shall be taxable in the latter State.

(2) Nevertheless, those dividends may be taxed in the Contracting State in which the company declaring the dividends has its seat and under the laws of that State, but the tax so payable may not exceed:

...

(b) 15 per cent of the gross amount of the dividends in any other case.'

The main proceedings and the question referred

5 In their joint income tax return for the year 2000, Mr and Mrs Weidert-Paulus claimed income tax relief under Article 129c of the Income Tax Law in the sum of

LUF 120 000 in relation to their subscription for 200 new shares in the capital of the Belgian company Interbrew SA. The amount subscribed was LUF 267 743.

6 The tax office dealing with the matter did not allow the claim on the ground that investment in the capital of a company which was not established in Luxembourg gave no entitlement to the relief in question.

7 Mr and Mrs Weidert-Paulus appealed against the decision rejecting their claim and, in the absence of a favourable response, they brought proceedings before the Tribunal Administratif (Administrative Court) (Luxembourg).

8 By judgment of 16 December 2002, the latter granted their application, holding that, in so far as Article 129c of the Income Tax Law favours undertakings having their seat in Luxembourg over those established in other Member States, it infringed the provisions of the EC Treaty on the free movement of capital, as interpreted by the Court in Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraphs 34 to 36.

9 The tax authorities brought an appeal against that judgment before the Cour Administrative, arguing that the court at first instance had not properly understood the implications of *Verkooijen.* According to the tax authorities, the facts in the main proceedings were in fact closer to those in Case C-204/90 *Bachmann* [1992] ECR I-249, where the Court accepted that the need to ensure cohesion of the tax system justified the unequal tax treatment of undertakings established in different Member States.

10 In those circumstances, as it considered that a decision on the interpretation of some of the provisions of the EC Treaty was necessary in the proceedings before it, the Cour Administrative decided to stay the proceedings and refer the following question to the Court for a preliminary ruling :

'Is Article 129c of the Income Tax Law of 4 December 1967, as amended, in the version applicable to the 2000 tax year, which, subject to certain conditions and limits, grants tax relief to taxpayers who are natural persons and acquire shares representing cash contributions in fully-taxable resident capital companies, compatible with the principle of the free movement of capital within the European Community as laid down by Article 56(1) of the EC Treaty, taking account of the restrictions on that principle laid down, inter alia, by Article 58(1)(a) of the EC Treaty?'

The question referred

11 By its question, the national court is essentially asking whether Article 56(1) EC and Article 58(1)(a) EC preclude a legal provision of a Member State which denies the availability of income tax relief to natural persons for the acquisition of shares representing cash contributions in capital companies established in other Member States.

12 It must be borne in mind at the outset that, according to settled case-law, although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law (see Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 16; *Verkooijen*, paragraph 32, and Case C-334/02 *Commission* v *France* [2004] ECR I-2229, paragraph 21).

13 A legislative provision such as the one at issue in the main proceedings has the effect of discouraging nationals of the Member State concerned from investing their capital in companies which have their seat in another Member State (see, by way of analogy, *Verkooijen*, paragraph 34). The title itself of the Law of 22 December 1993 shows that its purpose is 'the promotion of investment in the interest of economic development', and it is clear from the legislative background to Article 129c of the Income Tax Law, which was referred to both by Mr and Mrs Weidert-Paulus and by the Commission of the European Communities without challenge by the Luxembourg Government, that the provision in question has the direct object of promoting investment in companies having their seat in Luxembourg.

14 Such a provision also has a restrictive effect in relation to companies established in other Member States; it constitutes an obstacle to the raising of capital in Luxembourg since the acquisition of shares in those companies is less attractive than the acquisition of shares in companies which have their seats in that Member State (see, by way of analogy, *Verkooijen*, paragraph 35, and *Commission* v *France*, paragraph 24).

15 In those circumstances, it must be held that for a Member State to make the grant of tax relief to natural persons for the acquisition of shares representing cash contributions in capital companies conditional on the latter having their seat in that State is a restriction on the movement of capital prohibited by Article 56 EC.

16 The documents annexed to the observations submitted to the Court by Mr and Mrs Weidert-Paulus show that the Income Tax Law has been amended by a Law of 21 December 2001 to amend certain provisions relating to direct and indirect taxation (*Mémorial* A 2001, p. 3312), which progressively abolishes the tax relief during the period from 2002 until 2005. Regardless of those legislative developments, the Luxembourg Government is of the view that Article 129c of the Income Tax Law, in the version applicable to the facts in the main proceedings, is none the less justified. In its submission, Article 58(1)(a) EC allows Member States to apply the relevant provisions of their tax law which distinguish between taxpayers who are

not in the same situation with regard to their place of residence or with regard to the place where their capital is invested, where those distinctions are objectively justified or may be justified by overriding reasons in the general interest, in particular relating to the cohesion of the tax system.

17 Article 129c of the Income Tax Law aims precisely to guarantee that cohesion. The tax advantage represented by the tax relief for the acquisition of shares in companies established in Luxembourg is offset by the taxation of dividends subsequently paid by those companies. By contrast, where an investment is made in a company having its seat in Belgium, as in the main proceedings, tax on dividends would be reduced by 15 % because of the withholding tax of that amount imposed by the Belgian tax authorities under the Double Taxation Convention. In such a case, the Grand Duchy of Luxembourg would thus forgo the right to part of the tax, which would not apply in the case of dividends distributed by companies having their seat in that Member State. There is thus a direct connection, involving one and the same taxpayer, between the grant of the tax advantage and the offsetting of that advantage by a subsequent fiscal levy, both of which relate to the same tax, exactly as in *Bachmann.*

18 According to Mr and Mrs Weidert-Paulus and the Commission, that argument is without foundation. Article 58(1) EC must be read in conjunction with Article 58(3), which states that the measures and procedures in question are not to constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital. In the present case, there is clear discrimination between taxpayers, depending on which of the two Member States the seat of the companies concerned is located in.

19 Moreover, relief under Article 129c of the Income Tax Law is linked only to the acquisition of shares and is independent of any subsequent distributions by way of dividend. In many cases, there will never be a distribution by way of dividend. Furthermore, in Luxembourg, during the tax periods at issue in the main proceedings, unearned income was exempt from tax up to LUF 120 000 and was

taxed at a maximum of 50 % only when it exceeded that amount, so that it was only when a very large investment was made that tax was payable. The return by way of dividends on an investment of an amount equivalent to the relief in question will in any event be extremely low; Mr and Mrs Weidert-Paulus received a dividend in 2002 of EUR 28, whereas the investment made by them amounted to LUF 267 743. For the Grand Duchy to forgo tax at 15 % on the EUR 28 was thus of negligible significance compared with the amount of the tax relief.

20 In that regard, while it is true that the need to safeguard the cohesion of the tax system can justify a restriction on the exercise of the fundamental freedoms guaranteed by the Treaty (*Bachmann*, paragraph 28, and Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305, paragraph 21), such an exception to the fundamental principle of the free movement of capital must none the less be construed strictly and subject to the limitations of the doctrine of proportionality. In the cases which led to the two judgments referred to above, there was a direct link between the deductibility of the contributions and the taxation of sums payable by insurers under pension and life insurance contracts, and that link had to be maintained to preserve the cohesion of the tax system concerned (see, inter alia, Case C-55/98 *Vestergaard* [1999] ECR I-7641, paragraph 24, and Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 52).

21 Where there is no such direct link, the argument based on the cohesion of the tax system cannot be relied upon (see Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 40, and Case C-168/01 *Bosal* [2003] ECR I-9409, paragraph 30).

22 There is in the main proceedings no direct link between the tax advantage in question, namely the tax relief granted to a taxpayer resident in Luxembourg for the acquisition of shares in companies established in that Member State, and an offsetting fiscal levy.

23 Indeed, contrary to what the Luxembourg Government maintains, the tax advantage is not offset by the taxation of the dividends which those companies subsequently pay. First, there is no guarantee that the companies in which the investment giving rise to the tax benefit concerned is made will pay dividends, the taxation of which may offset the tax benefit granted. Secondly, as Mr and Mrs Weidert-Paulus and the Commission have argued, even if dividends are paid to the recipients of the tax advantage by the companies concerned, the amount of that advantage will significantly exceed any benefit which may result from any subsequent taxation of the dividends.

24 Similarly, the inability to take advantage of the Double Tax Convention cannot be regarded as disadvantageous to persons investing in companies established in Luxembourg. In that regard, the forgoing by the Grand Duchy of Luxembourg under that Convention of part of the tax on dividends, which the Luxembourg Government relies on to justify the relief in question, provides no benefit to the taxpayer concerned. The latter must account for the amount of that tax to the Belgian tax authorities in the form of a deduction at source. The Convention only precludes the amount of the dividends received by the taxpayer being taxed twice, but it does not provide for such an amount to be exempt from tax.

25 In any event, even if a link were to exist under Luxembourg law between the tax advantage and the taxation of dividends, it must be held that the effect of the Double Taxation Convention concluded by the Grand Duchy of Luxembourg with the Kingdom of Belgium is to shift fiscal cohesion to the level of the reciprocity of the rules applicable in the Contracting States (see, inter alia, *Wielockx*, paragraph 24, and *X and Y*, paragraph 53). The Convention in question creates a fiscal reciprocity, inasmuch as in forgoing 15 % of the net amount of dividends paid by companies established in Belgium to individuals subject to Luxembourg income tax, the Grand Duchy of Luxembourg may in return receive 15 % of the dividends paid by companies having their seat in that Member State to individuals subject to income tax in Belgium.

26 As the specific aim of the Double Taxation Convention is to secure fiscal cohesion, that Convention may not be invoked to justify an inconsistency as regards the taxpayer, which must be remedied by the introduction of the relief which is the subject of the main proceedings (see, by way of analogy, *Wielockx*, paragraph 25).

27 The interpretation of the Luxembourg Government, founded on the need to maintain the cohesion of the tax system, is thus not well founded.

28 The reply to the question referred must therefore be that Article 56(1) EC and Article 58(1)(a) EC preclude a legal provision of a Member State which denies the availability of income tax relief to natural persons for the acquisition of shares representing cash contributions in capital companies established in other Member States.

Costs

29 The costs incurred by the Luxembourg 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),

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in answer to the questions referred to it by the Cour Administrative by judgment of 3 June 2003, hereby rules:

Article 56(1) EC and Article 58(1)(a) EC preclude a legal provision of a Member State which denies the availability of income tax relief to natural persons for the acquisition of shares representing cash contributions in capital companies established in other Member States.

Jann Rosas Silva de Lapuerta

Delivered in open court in Luxembourg on 15 July 2004.

R. Grass P. Jann

Registrar President of the First Chamber