JUDGMENT OF THE COURT (Grand Chamber)

12 July 2005 *

In Case C-403/03,

REFERENCE under Article 234 EC for a preliminary ruling from the Bundesfinanzhof (Germany), made by decision of 22 July 2003, received at the Court on 29 September 2003, in the proceedings

Egon Schempp

v

Finanzamt München V,

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann, C.W.A. Timmermans and A. Rosas, Presidents of Chambers, C. Gulmann, J.-P. Puissochet, A. La Pergola, R. Schintgen, N. Colneric, J. Klučka, U. Lõhmus, E. Levits and A. Ó Caoimh (Rapporteur), Judges,

* Language of the case: German.

Advocate General: L.A. Geelhoed,
Registrar: R. Grass,

having regard to the written procedure,

after considering the observations submitted on behalf of:

— Mr Schempp, by J. Seest, Rechtsanwalt,

— the German Government, by W.-D. Plessing and A. Tiemann, acting as Agents,

— the Netherlands Government, by H.G. Sevenster and C.A.H.M. ten Dam, acting as Agents,

— the Commission of the European Communities, by K. Gross and R. Lyal, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 27 January 2005,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 12 EC and 18 EC.

2 The reference was made in the course of proceedings between Mr Schempp and the Finanzamt München V (Munich V Tax Office, 'the Finanzamt'), concerning the latter's refusal to regard the maintenance paid by Mr Schempp to his former spouse resident in Austria as special expenditure deductible in respect of income tax.

Law

3 Under Paragraph 10(1)(1) of the Einkommensteuergesetz (Law on Income Tax, 'the EStG'), the following expenditure constitutes 'special expenditure' if it is neither operating expenditure nor advertising costs:

'Maintenance payments to a divorced or separated spouse who is subject to unlimited income tax liability, if the debtor applies for this with the consent of the recipient, up to DEM 27 000 per calendar year. An application may be made only for one calendar year at a time and may not be withdrawn ...'

4 Under Paragraph 22(1a) of the EStG, the amounts which are deductible by the maintenance debtor form part of the taxable income of the recipient, under the principle of 'correspondence'. The deduction which the debtor is entitled to make is not conditional on the recipient actually paying tax on those amounts. However, if the recipient has to pay tax on the maintenance payments received, it is the maintenance debtor who is, under civil law, liable to pay that tax.

5 Under Paragraph 1a(1)(1) of the EStG:

'Maintenance payments to a divorced or separated spouse (Paragraph 10(1)(1)) are also deductible as special expenditure if the recipient is not subject to unlimited income tax liability. It is a condition that the recipient has his principal or habitual residence in the territory of another Member State of the European Union or of a State to which the Agreement on the European Economic area applies. It is a further condition that the taxation of the maintenance payments in the hands of the recipient is proved by a certificate of the competent foreign tax authorities ...'

6 Pursuant to Paragraph 52(2) of the EStG, Paragraph 1a(1)(1) applies to the Republic of Austria from the 1994 tax year, since that State acceded to the Agreement on the European Economic Area on 1 January 1994.

The main proceedings and the questions referred for a preliminary ruling

7 Following his divorce, Mr Schempp, a German national resident in Germany, pays maintenance to his former spouse resident in Austria.

8 In his tax declarations for the tax years 1994 to 1997, Mr Schempp sought to deduct the maintenance payments, in accordance with the first and second sentences of

Paragraph 1a(1)(1) of the EStG. However, in his income tax assessments for 1994 to 1997, the Finanzamt refused him the deduction on the ground that it had not received a certificate from the Austrian tax authorities to show that his former spouse had been taxed in Austria on the maintenance payments, as prescribed by the third sentence of Paragraph 1a(1)(1).

9 Mr Schempp was unable to produce such a certificate, as Austrian tax law excludes, in principle, taxation of maintenance payments and does not allow them to be deducted. The documents in the case show, however, that Mr Schempp would have been able to deduct the total amount of the maintenance payments to his former spouse if she had been resident in Germany. In that case, she for her part would not have paid any tax on the maintenance, as her income is less than the taxable minimum in Germany.

10 Since he considered that the German legislation in question was incompatible with Articles 12 EC and 18 EC, Mr Schempp lodged objections against the Finanzamt's assessments. The Finanzamt rejected the objections by decision of 27 July 1999.

11 After his action brought against that decision was dismissed by the Finanzgericht München (Finance Court, Munich), Mr Schempp appealed on a point of law to the Bundesfinanzhof (Federal Finance Court). That court, taking the view that the proceedings raised questions of interpretation of Community law, decided to stay the proceedings and refer the following two questions to the Court for a preliminary ruling:

'1. Is Article 12 EC to be interpreted as meaning that Paragraph 1a(1)(1) and Paragraph 10(1)(1) of the EStG, to the effect that a taxpayer resident in

Germany is not entitled to deduct maintenance payments to his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany, are incompatible therewith?

2. If Question 1 is answered in the negative: is Article 18(1) EC to be interpreted as meaning that Paragraph 1a(1)(1) and Paragraph 10(1)(1) of the EStG, to the effect that a taxpayer resident in Germany is not entitled to deduct maintenance payments for his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany, are incompatible therewith?'

The questions referred for a preliminary ruling

12 By its questions the referring court asks essentially whether the first paragraph of Article 12 EC and Article 18(1) EC must be interpreted as precluding a taxpayer resident in Germany from being unable, under the national legislation at issue in the main proceedings, to deduct from his taxable income in that Member State the maintenance paid to his former spouse resident in Austria, where he would have been entitled to do so if she were still resident in Germany.

13 The first point to examine is whether the situation at issue in the main proceedings falls within the scope of Community law.

14 It should be recalled that the first paragraph of Article 12 EC prohibits, within the scope of application of the Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality.

15 To assess the scope of application of the Treaty within the meaning of Article 12 EC, that article must be read in conjunction with the provisions of the Treaty on citizenship of the Union. Citizenship of the Union is destined to be the fundamental status of nationals of the Member States, enabling those who find themselves in the same situation to receive the same treatment in law irrespective of their nationality, subject to such exceptions as are expressly provided for (Case C-184/99 *Grzelczyk* [2001] ECR I-6193, paragraphs 30 and 31, Case C-148/02 *Garcia Avello* [2003] ECR I-11613, paragraphs 22 and 23, and Case C-209/03 *Bidar* [2005] ECR I-2119, paragraph 31).

16 Under Article 17(1) EC, every person holding the nationality of a Member State is a citizen of the Union. Mr Schempp, as a German national, thus has such citizenship.

17 As the Court has already held, Article 17(2) EC attaches to the status of citizen of the Union the rights and duties laid down by the Treaty, including the right to rely on Article 12 EC in all situations falling within the material scope of Community law (see Case C-85/96 *Martínez Sala* [1998] ECR I-2691, paragraph 62).

18 Those situations include those involving the exercise of the fundamental freedoms guaranteed by the Treaty and those involving the exercise of the right to move and reside within the territory of the Member States, as conferred by Article 18 EC (*Bidar*, paragraph 33).

19 While in the present state of Community law direct taxation falls within the competence of the Member States, the latter must none the less exercise that competence in accordance with Community law, in particular the provisions of the

Treaty concerning the right of every citizen of the Union to move and reside freely within the territory of the Member States, and therefore avoid any overt or covert discrimination on the basis of nationality (see, to that effect, Case C-279/93 *Schumacker* [1995] ECR I-225, paragraphs 21 and 26, and Case C-385/00 *De Groot* [2002] ECR I-11819, paragraph 75).

20 However, it also follows from the case-law that citizenship of the Union, established by Article 17 EC, is not intended to extend the material scope of the Treaty to internal situations which have no link with Community law (Joined Cases C-64/96 and C-65/96 *Uecker and Jacquet* [1997] ECR I-3171, paragraph 23, and *Garcia Avello*, paragraph 26).

21 According to the German and Netherlands Governments, the main proceedings relate to such a situation. The person relying on Article 12 EC, in the present case Mr Schempp, did not make use of his right of free movement laid down by Article 18 EC. His former spouse did indeed exercise such a right. The present case, however, does not concern her taxation but that of Mr Schempp. The German Government therefore observes that in the present case the only factor external to the Federal Republic of Germany is the fact that Mr Schempp is paying maintenance to a person resident in another Member State. Since maintenance payments have no effect on intra-Community trade in goods and services, however, the situation does not fall within Article 12 EC.

22 On this point, it must be observed that, contrary to the submissions of the German and Netherlands Governments, the situation of a national of a Member State who, like Mr Schempp, has not made use of the right to freedom of movement cannot, for

that reason alone, be assimilated to a purely internal situation (see, to that effect, Case C-200/02 *Zhu and Chen* [2004] ECR I-9925, paragraph 19).

23 While it is correct that Mr Schempp has not exercised such a right, it is nevertheless common ground that his former spouse, by establishing her residence in Austria, exercised the right granted by Article 18 EC to every citizen of the Union to move and reside freely in the territory of another Member State.

24 As the Advocate General observed, in substance, in point 19 of his Opinion, since, for the purposes of determining the deductibility of maintenance paid by a taxpayer resident in Germany to a recipient resident in another Member State, the national legislation at issue in the main proceedings takes account of the fiscal treatment of those payments in the State of residence of the recipient, it necessarily follows that the exercise in the present case by Mr Schempp's former spouse of her right to move and reside freely in another Member State under Article 18 EC was such as to influence her former husband's capacity to deduct the maintenance payments made to her from his taxable income in Germany.

25 It follows from all the foregoing that, since the exercise by Mr Schempp's former spouse of a right conferred by the Community legal order had an effect on his right to deduct in his Member State of residence, such a situation cannot be regarded as an internal situation with no connection with Community law.

26 The Court must therefore examine whether Articles 12 EC and 18 EC preclude the German tax authorities from refusing deduction of the maintenance paid by Mr Schempp to his former spouse resident in Austria.

Application of Article 12 EC

27 It is common ground that if Mr Schempp's former spouse had been resident in Germany he would have been entitled to deduct the maintenance payments made to her. Since, however, she was resident in Austria, the German tax authorities refused him that deduction.

28 It is settled case-law that the principle of non-discrimination requires that comparable situations must not be treated differently unless such treatment is objectively justified (see Case C-354/95 *National Farmers' Union and Others* [1997] ECR I-4559, paragraph 61).

29 It must therefore be examined whether the situation of Mr Schempp, who pays maintenance to his former spouse resident in Austria without being able to deduct those payments in his income tax declaration, can be compared to that of a person who makes such payments to a former spouse resident in Germany and enjoys that tax advantage.

30 Under the third sentence of Paragraph 1a(1)(1) of the EStG, the deductibility in Germany of maintenance payments by a taxpayer resident in that Member State to a recipient resident in another Member State is conditional on their being taxed in that other Member State.

31 It follows that since, in the main proceedings, the maintenance payments were not taxed in the Member State of residence of Mr Schempp's former spouse, he was not allowed to deduct those payments from his income in Germany.

32 In those circumstances, it is apparent that the unfavourable treatment of which Mr Schempp complains in fact derives from the circumstance that the tax system applicable to maintenance payments in his former spouse's Member State of residence differs from that applied in his own Member State of residence.

33 As the Netherlands Government points out, if his former spouse had chosen to reside in a Member State, such as the Netherlands, in which — contrary to the situation in Austria — maintenance payments are taxed, Mr Schempp would have been entitled under the national legislation at issue in the present case to deduct the maintenance payments made to her.

34 It is settled case-law that Article 12 EC is not concerned with any disparities in treatment, for persons and undertakings subject to the jurisdiction of the Community, which may result from divergences existing between the various

Member States, so long as they affect all persons subject to them in accordance with objective criteria and without regard to their nationality (see, to that effect, Case C-137/00 *Milk Marque and National Farmers' Union* [2003] ECR I-7975, paragraph 124 and the case-law cited there).

35 It follows that, contrary to Mr Schempp's claims, the payment of maintenance to a recipient resident in Germany cannot be compared to the payment of maintenance to a recipient resident in Austria. The recipient is subject in each of those two cases, as regards taxation of the maintenance payments, to a different tax system.

36 Consequently, the fact that a taxpayer resident in Germany is not able, under Paragraph 1a(1)(1) of the EStG, to deduct maintenance paid to his former spouse resident in Austria does not constitute discrimination within the meaning of Article 12 EC.

37 According to Mr Schempp, the unequal treatment of which he is the subject in the present case derives, however, from the fact that, while deductibility of maintenance paid to a person resident in Germany is not conditional on that person actually paying tax, actual payment of tax is required for deductibility of maintenance paid to a person resident in the territory of another Member State.

38 However, it must be recalled that in the present proceedings the national court solely asks the Court whether Community law precludes a taxpayer resident in

Germany from being unable to deduct the maintenance paid to his former spouse resident in Austria. Consequently, for the purpose of providing the national court with an interpretation which will be of use to it in giving its decision in the main proceedings, it must be concluded that the point raised by Mr Schempp, in that it concerns the payment of maintenance to a recipient resident in another Member State in which maintenance payments are taxable, does not arise in the present case, as it is common ground that maintenance payments are not taxable in Austria.

39 As to the undisputed fact that, if Mr Schempp's former spouse had resided in Germany, he would have been entitled to deduct the maintenance paid to her, even though in such a case the maintenance would not have been taxed because his former spouse's income in Germany during the period in question was below the tax thresholds applied by German tax legislation, that cannot call into question the conclusion in paragraph 36 above. As the Commission of the European Communities rightly observes, the non-taxation of maintenance payments on those grounds in Germany cannot be equated to the non-taxation of the maintenance in Austria on the ground of its non-taxable character in that Member State, since the fiscal consequences which attach to each of those situations as regards the taxation of income are different for the taxpayers concerned.

Application of Article 18 EC

40 Under Article 18(1) EC, '[e]very citizen of the Union shall have the right to move and reside freely within the territory of the Member States, subject to the limitations and conditions laid down in [the] Treaty and by the measures adopted to give it effect'.

41 As a national of a Member State and hence a citizen of the Union, Mr Schempp is entitled to rely on that provision.

42 In his observations, Mr Schempp submits that Article 18(1) EC protects not only the right to move and settle in other Member States but also the right to choose one's residence. He submits that, since the maintenance payments are not deductible from taxable income where the recipient resides in another Member State, the recipient could be subject to a certain pressure not to leave Germany, thus constituting a restriction on the exercise of the rights guaranteed by Article 18(1) EC. That pressure could materialise specifically at the time when the amount of the maintenance is determined, since that determination takes the tax implications into account.

43 On this point, it is clear that, as the German and Netherlands Governments and the Commission submit, the national legislation in question does not in any way obstruct Mr Schempp's right, as a citizen of the Union, to move and reside in other Member States under Article 18(1) EC.

44 As has been observed, it is true that the transfer of his former spouse's residence to Austria entailed unfavourable tax consequences for Mr Schempp in his Member State of residence.

45 However, the Court has already held that the Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in

which he previously resided will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage in terms of indirect taxation or not, according to circumstances (see, to that effect, Case C-365/02 *Lindfors* [2004] ECR I-7183, paragraph 34).

46 The same principle applies a fortiori to a situation such as that at issue in the main proceedings where the person concerned has not himself made use of his right of movement, but claims to be the victim of a difference in treatment following the transfer of his former spouse's residence to another Member State.

47 In those circumstances, the answer to the questions referred must be that the first paragraph of Article 12 EC and Article 18(1) EC must be interpreted as not precluding a taxpayer resident in Germany from being unable, under national legislation such as that at issue in the main proceedings, to deduct from his taxable income in that Member State the maintenance paid to his former spouse resident in another Member State in which the maintenance is not taxable, where he would be entitled to do so if his former spouse were resident in Germany.

Costs

48 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. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) rules as follows:

The first paragraph of Article 12 EC and Article 18(1) EC must be interpreted as not precluding a taxpayer resident in Germany from being unable, under national legislation such as that at issue in the main proceedings, to deduct from his taxable income in that Member State the maintenance paid to his former spouse resident in another Member State in which the maintenance is not taxable, where he would be entitled to do so if his former spouse were resident in Germany.

[Signatures]