JUDGMENT OF THE COURT (Second Chamber)

17 January 2008 (*)

(Free movement of capital – Articles 73b and 73d of the EC Treaty (now Articles 56 EC and 58 EC) – Inheritance tax – Valuation of assets forming part of the estate – Agricultural and forestry assets in another Member State – Less favourable method of valuation of assets and calculation of the tax payable)

In Case C-256/06,

REFERENCE for a preliminary ruling under Article 234 EC from the Bundesfinanzhof (Germany) made by decision of 11 April 2006, received at the Court on 8 June 2006, in the proceedings

**Theodor Jäger**

v

**Finanzamt Kusel-Landstuhl,**

THE COURT (Second Chamber),

composed of C.W.A. Timmermans, President of the Chamber, L. Bay Larsen (Rapporteur), K. Schiemann, J. Makarczyk and C. Toader, Judges,

Advocate General: J. Mazák,

Registrar: R. Grass,

having regard to the written procedure,

after considering the observations submitted on behalf of:

– Mr Jäger, by K. Cronauer, Rechtsanwältin,

– the Finanzamt Kusel-Landstuhl, by M. Trauten, acting as Agent,

– the German Government, by M. Lumma and U. Forsthoff, acting as Agents,

– the Commission of the European Communities, by R. Lyal and W. Mölls, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 11 September 2007,

gives the following

**Judgment**

1 This reference for a preliminary ruling relates to the interpretation of Articles 73b and 73d of the EC Treaty (now Articles 56 EC and 58 EC respectively).

2 The reference has been made in proceedings between Mr Jäger and the Finanzamt (Tax Office) Kusel-Landstuhl ('the Finanzamt') concerning the calculation of the inheritance tax payable in respect of an inheritance consisting of assets situated in Germany and property in the form of agricultural land and forestry situated in France and, in particular, the rules on the valuation of those assets.

## Legal framework

*Community legislation*

3 Annex I to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [Article repealed by the Treaty of Amsterdam] (OJ 1988 L 178, p. 5), entitled 'Nomenclature of the capital movements referred to in Article 1 of the Directive', includes 13 categories of capital movements.

4 The 11th of those categories, relating to 'Personal capital movements', includes a heading entitled 'Inheritances and legacies'.

*National legislation*

Application of inheritance tax to assets situated in another Member State

5 Under the first point of Paragraph 2(1) of the Law on inheritance and gift tax (Erbschaftsteuer- und Schenkungsteuergesetz), in the version published in BGBl. 1997 I, p. 378 ('the ErbStG'), the entire estate of a person domiciled in Germany is subject to inheritance tax on the date on which liability to the tax arises. Assets situated outside Germany are also subject to that tax.

6 Paragraph 21 of the ErbStG governs, for the purposes of calculating the inheritance tax in Germany, the offsetting of inheritance tax paid in another State in the absence of a double-taxation agreement. The first sentence of Paragraph 21(1) provides:

'Where the foreign property of acquirors is subject, in a foreign country, to a foreign tax corresponding to German inheritance tax, the foreign tax set and payable by the acquiror, paid and not eligible for reduction, shall, in the cases referred to in the first point of Paragraph 2(1) and, in so far as the provisions of a double-taxation agreement do not apply, be offset, if an application is made for that purpose, against the German inheritance tax in so far as the foreign assets are also subject to German inheritance tax.'

7 The second sentence of Paragraph 21(1) states:

'If the property transferred consists only partly of foreign property, the portion of the German inheritance tax corresponding to that property must be determined in such a way that the inheritance tax arising in respect of the total amount of the taxable property, including foreign taxable property, is divided up proportionally between the foreign taxable property and the total amount of taxable property.'

Rules for valuation of agricultural and forestry assets

8 Under Paragraph 12(6) of the ErbStG, read in conjunction with Paragraphs 9 and 31 of the Law on Valuation (Bewertungsgesetz, BGBl. 1991 I, p. 230; 'the BewG'), property consisting of agricultural land and forestry situated outside Germany is to be valued according to its fair market value. Under Paragraph 9(2) of the BewG, that value is defined as the price at which those assets could be sold in the ordinary course of business.

9 By contrast, under Paragraph 12(3) of the ErbStG property consisting of agricultural land and forestry situated in Germany is to be valued under a special procedure laid down in Paragraphs 140 to 144 of the BewG. The valuations carried out in accordance with that procedure amount, on average, to only 10% of the current market value of the assets in question.

10 Those provisions of the BeWG, which were inserted into that Law by point 36 of Paragraph 1 of the 1997 Annual Tax Law (Jahressteuergesetz 1997, BGBl. 1996 I, p. 2049) of 20 December 1996, enable the entire domestic holding of agricultural land and forestry to be valued under a simplified procedure for calculating the value of yield which has recourse to standardised values for the different types of holdings and is based, in particular, on the average constant yields of profit-making holdings in Germany on 1 January 1996. In the alternative, and on request, the BewG provides for a valuation under the procedure based on individual income.

Rules for calculating the inheritance tax on agricultural land and forestry assets

11 The first point of Paragraph 13a(1) of the ErbStG provides, in respect of the acquisition by inheritance of agricultural land and forestry situated in Germany, for 'tax-free amounts in relation to specific objects' of DEM 500 000 on the value of that property, which is added to the personal tax-free amount of DEM 400 000 granted under Paragraph 16 of that Law.

12 Further, under Paragraph 13a(2) of the ErbStG, the remaining value of that property, after deduction of the tax-free amount granted in relation to those objects, is to be taken into account, for the purposes of calculating the tax, in the form of a 'valuation at a reduced rate' of only 60%.

13 Paragraph 13a(4) of the ErbStG provides that the tax-free amount granted in relation to those objects and the valuation at a reduced rate do not apply to agricultural land and forestry situated outside Germany.

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

14 Mr Jäger, who is resident in France, is the sole heir of his mother, who died in 1998 and was last living in Germany.

15 In addition to assets in Germany, the estate contained land in France used for agriculture and forestry. Mr Jäger's father, who himself died in 1994, had acquired one part of that property in August 1988 and subsequently acquired plots forming the other part of that property in January 1990.

16 Since it had been valued in France as having a fair market value of FRF 5 444 666 (DEM 1 618 152), that land was subject to inheritance tax in that Member State of FRF 1 192 148 (DEM 354 306).

17 By decision of 3 January 2000, the Finanzamt calculated the inheritance tax payable by Mr Jäger.

18 That tax was calculated on a net estate of DEM 1 737 167, including the land situated in France,

totalling DEM 1 618 152, being its fair market value, and assets in Germany, valued at DEM 119 015. After deduction of the personal tax-free amount of DEM 400 000, the taxable amount was rounded down to DEM 1 337 100. On the basis of that amount, the Finanzamt set the tax at DEM 254 049.

19 On application by Mr Jäger brought under the second sentence of Paragraph 21(1) of the ErbStG, the Finanzamt offset against that latter amount DEM 236 644 in respect of the inheritance tax already paid in France.

20 On the basis of those factors, in its abovementioned decision of 3 January 2000, the Finanzamt set the inheritance tax payable by Mr Jäger at DEM 17 405.

21 Mr Jäger entered an objection against the Finanzamt's decision and brought an action before the Finanzgericht. As the objection and action were both unsuccessful, he then appealed on a point of law to the Bundesfinanzhof. Taking the view that, at least since the judgment of the Court of Justice in Case C-364/01 *Barbier* [2003] ECR I-15013, it was doubtful whether the provisions of German law, to the extent to which they differentiate according to the place in which the assets included in the estate or a part thereof are located, are reconcilable with the principle of the free movement of capital, the Bundesfinanzhof decided to stay the proceedings and refer the following question to the Court for a preliminary ruling:

'Is it compatible with Article 73b(1) of the Treaty establishing the European Community (now Article 56(1) EC) that for inheritance tax purposes:

(a) assets (held abroad) consisting of agricultural land and forestry situated in another Member State are valued in accordance with their fair market value (current market value), whereas a special valuation procedure exists for domestic assets consisting of agricultural land and forestry, the results of which amount on average to only 10% of their fair market value, and

(b) assessment of the acquisition of domestic assets consisting of agricultural land and forestry is excluded up to a special tax-free amount and the remaining value is assessed merely at 60%,

if, in the case of an heir inheriting an estate made up of both domestic assets and foreign assets consisting of agricultural land and forestry, this results in a situation whereby, as a result of the fact that the assets consisting of agricultural land and forestry are situated abroad, the acquisition of the domestic assets is subject to higher inheritance tax than would be applicable if the assets consisting of agricultural land and forestry were also domestic assets?'

**The question referred**

22 By its question, the Bundesfinanzhof asks, essentially, whether Article 73b(1) of the Treaty precludes legislation of a Member State, such as that at issue in the main proceedings, which, for the purposes of calculating the tax on an inheritance consisting of assets situated in the territory of that State and agricultural land and forestry situated in another Member State,

– provides that account be taken of the fair market value of the assets situated in that other Member State, whereas a special valuation procedure exists for identical domestic assets, the results of which amount on average to only 10% of the fair market value of those assets, and

– reserves application of a tax-free amount to domestic agricultural land and forestry in relation to

those assets and takes account of their remaining value in the amount of only 60% thereof.

23 First of all, it must be noted that, although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law (see, inter alia, Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 19; Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] ECR I-8203, paragraph 15; and Case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647, paragraph 21).

24 It must also be observed that the EC Treaty does not define the term 'movement of capital'. However, it is settled case-law that, inasmuch as Article 73b of the Treaty substantially reproduced the content of Article 1 of Directive 88/361, and even if the latter was adopted on the basis of Articles 69 and 70(1) of the EEC Treaty (Articles 67 to 73 of the EEC Treaty were replaced by Articles 73b to 73g of the EC Treaty, now Articles 56 EC to 60 EC), the nomenclature relating to capital movements annexed thereto retains the same indicative value as before for the purposes of defining the term 'movement of capital' (see, inter alia, Case C-513/03 v*an Hilten-van der Heijden* [2006] ECR I-1957, paragraph 39, and Case C-452/04 *Fidium Finanz* [2006] ECR I-9521, paragraph 41).

25 In that regard, the Court, noting in particular that inheritances involving a transfer to one or more persons of assets left by the deceased fall within heading XI of Annex I to Directive 88/361, entitled 'Personal capital movements', held in paragraph 42 of the judgment in *van Hilten-van der Heijden* that an inheritance is a movement of capital within the meaning of Article 73b of the Treaty (see also, to that effect, *Barbier*, paragraph 58), except in cases where its constituent elements are confined within a single Member State.

26 However, a situation in which a person resident in Germany at the time of his death leaves to another person resident in France assets situated in those two Member States and covered jointly by a calculation of inheritance tax in Germany is certainly not a purely domestic situation, as the Commission of the European Communities has correctly pointed out.

27 Consequently, the inheritance here at issue in the main proceedings constitutes a movement of capital within the meaning of Article 73b(1) of the Treaty.

28 It is thus necessary to examine, first, whether, as maintained by Mr Jäger and the Commission, a national provision such as that at issue in the main proceedings amounts to a restriction on the movement of capital.

29 The German Government submits that the national legislation at issue in the main proceedings does not amount to a restriction on the movement of capital. First, it submits that, since the assets situated in France were acquired initially by the father of Mr Jäger before 1 June 1990, the date by which Directive 88/361 had to be transposed into national law, the rights deriving from that directive or from the Treaty could not be relied on directly by the purchaser of the assets concerned. Secondly, according to the German Government, such a purchaser cannot be deterred by the effects of legislation such as that at issue in the main proceedings, which does not in any way affect the person in question but, at the very most, his heirs. For that reason, the effects of such legislation are too indirect to be capable of constituting a restriction on the movement of capital.

30 In that respect, according to the case-law of the Court, national provisions which determine the value of immovable property for the purposes of calculating the amount of tax due when it is acquired through inheritance may not only be such as to discourage the purchase of immovable property situated

in the Member State concerned and the transfer of financial ownership of such property to another person by a resident of another Member State, but may also have the effect of reducing the value of the inheritance of a resident of a Member State other than that in which that property is situated (see to that effect, *Barbier*, paragraph 62).

31 Furthermore, as regards inheritances, the case-law has confirmed that the measures prohibited by Article 73b(1) of the Treaty as being restrictions on the movement of capital include those the effect of which is to reduce the value of the inheritance of a resident of a State other than the Member State in which the assets concerned are situated and which taxes the inheritance of those assets (*van Hilten-van der Heijden*, cited above, paragraph 44).

32 In the present case, the national provisions in issue in the main proceedings, in so far as they result in an inheritance consisting of agricultural land and forestry situated in another Member State being subject, in Germany, to inheritance tax that is higher than that which would be payable if the assets inherited were situated exclusively within the territory of that Member State, have the effect of restricting the movement of capital by reducing the value of an inheritance consisting of such an asset situated outside Germany.

33 That conclusion cannot be called into question by the arguments put forward by the German Government, noted in paragraph 29 of this judgment, since they are irrelevant in the light of the criteria arising from the case-law cited in paragraphs 30 and 31 of this judgment. In the present case, the effects of the national legislation in issue in the main proceedings on the value of the inheritance occurred after 1 June 1990 and are manifestly not too indirect to be capable of constituting a restriction on the movement of capital.

34 The same is true of the German Government's argument that there cannot be a restriction resulting from a reduction in the value of the inheritance, since the effect of legislation such as that at issue in the main proceedings is merely the unavoidable consequence of the coexistence of national tax systems. That circumstance is irrelevant in the light of the criteria resulting from the case-law cited in paragraphs 30 and 31 of this judgment. Indeed, in any event it is clear that the reduction in the value of the estate flows solely from the application of the German legislation at issue.

35 It follows that the fact that the grant of tax advantages in relation to inheritance tax is made subject to the condition that the asset acquired by inheritance be situated in the national territory constitutes a restriction on the free movement of capital prohibited, in principle, by Article 73b(1) of the Treaty.

36 Next, it is necessary to examine whether the restriction on the free movement of capital thus determined may be justified having regard to the provisions of the Treaty.

37 In that respect, it should be noted that, under Article 73d(1)(a) of the Treaty, '… Article 73b shall be without prejudice to the right of 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 … the place where their capital is invested'.

38 According to the Finanzamt and the German Government, under that provision the Federal Republic of Germany is entitled to reserve the benefit of assessment under the special procedure solely to assets situated within its territory. The Finanzamt adds that Paragraph 31 of the BewG is justified by Article 73d(1)(a) of the Treaty, read in the light of Declaration No 7 annexed to the Final Act of the Treaty on European Union, since the set of rules for the valuation of assets situated abroad, at issue in the main

proceedings, existed at the end of 1993, within the terms of that declaration.

39 Without the need to rule on whether those rules for the valuation of assets situated abroad existed on 31 December 1993, it should be noted that in the judgment in Case C-35/98 *Verkooijen* [2000] ECR I-4071, the Court was required to address arguments based on Article 73d(1)(a) of the Treaty, although the facts in the main proceedings in that case occurred before that provision came into force. It stated that, before the entry into force of Article 73d(1)(a) of the Treaty, national tax provisions of the kind to which that article refers, in so far as they establish certain distinctions, could be compatible with Community law provided that they applied to situations which were not objectively comparable (paragraph 43).

40 That stated, Article 73d(1)(a) of the Treaty, in so far as it is a derogation from the fundamental principle of the free movement of capital, must be interpreted strictly. That provision cannot therefore be interpreted as meaning that all tax legislation which draws a distinction between taxpayers based on their place of residence or the Member State in which they invest their capital is automatically compatible with the Treaty.

41 The derogation provided for in Article 73d(1)(a) of the Treaty is itself, as the German Government observed, limited by Article 73d(3) of the Treaty, which provides that the national provisions referred to in paragraph 1 of that article 'shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 73b' (see *Verkooijen*, paragraph 44, and *Manninen*, paragraph 28). Moreover, in order to be justified, the difference in treatment between the agricultural land and forestry assets situated in Germany and those situated in the other Member States must not go beyond what is necessary to achieve the objective pursued by the legislation at issue.

42 A distinction must therefore be made between the unequal treatment permitted under Article 73d(1)(a) of the Treaty and arbitrary discrimination prohibited under Article 73d(3). According to the case-law, in order for national tax legislation such as that at issue in the main proceedings, which, for the purposes of calculating inheritance tax, distinguishes between assets situated in another Member State and those situated in Germany, to be considered compatible with the provisions of the Treaty on the free movement of capital, the difference in treatment must concern situations which are not objectively comparable or be justified by overriding reasons in the general interest (see *Verkooijen*, paragraph 43, *Manninen*, paragraph 29, and Case C-443/06 *Hollmann* [2007] ECR I-0000, paragraph 45).

43 In that respect, it must be stated, first, that the difference in the amount of tax paid according to whether the inheritance consists only of agricultural land and forestry situated in Germany or consists also of such an asset situated in another Member State cannot be justified on the ground that it concerns situations which are not objectively comparable.

44 The calculation of the tax is, under the national legislation at issue in the main proceedings, directly linked to the value of the assets included in the estate, with the result that there is objectively no difference in situation such as to justify unequal tax treatment so far as concerns the level of inheritance tax payable in relation to, respectively, an asset situated in Germany and an asset situated in another Member State. A situation such as that of Mr Jäger is therefore comparable to that of any other heir whose inheritance consists only of agricultural land and forestry situated in Germany bequeathed by a person domiciled in that State.

45 Accordingly, it is, finally, necessary to examine whether the restriction on the movement of capital

resulting from legislation such as that at issue in the main proceedings may be objectively justified by an overriding reason in the general interest.

46 The German Government submits that there is an overriding reason in the general interest which justifies that legislation.

47 First of all, it points out that that legislation is designed to compensate for the specific costs involved in maintaining the social role fulfilled by agricultural land and forestry holdings. That legislation makes it possible to prevent, first, the heir to an agricultural company from being forced to sell or relinquish it in order to be able to pay the inheritance tax and, secondly, the break-up of agricultural land and forestry holdings guaranteeing productivity and jobs and also required to comply with their obligations under the national legal order.

48 In the view of the German Government, that overriding reason in the general interest could be considered the same as, indeed, the need to safeguard the coherence of the tax system. There is, it argues, a direct link between the specific obligations resulting from the subordination of those holdings to the general interest and the particular kind of valuation applied to those holdings in inheritance matters.

49 The Finanzamt and the German Government also submit that the legislation at issue in the main proceedings is justified by the fact that the German authorities are not obliged to take account of the existence of a comparable general interest in other Member States. That is the case since the specific obligations and costs associated with agricultural land and forestry in Germany do not necessarily weigh in the same manner on similar assets situated in other Member States. In that respect, the Finanzamt adds that, even if comparable obligations and costs were imposed in other Member States on those kinds of assets, the Federal Republic of Germany would not be required to ensure compensation in respect of them.

50 It is, admittedly, conceivable that objectives connected with the carrying on of the activities of agricultural and forestry holdings and preservation of jobs in the latter in cases of inheritance may in themselves, in certain circumstances and under certain conditions, be in the public interest and capable of justifying restrictions on the free movement of capital (see, to that effect, Case C-370/05 *Festersen* [2007] ECR I-1129, paragraph 28).

51 However, with regard to the arguments put forward by the Finanzamt and the German Government, these have been unable to demonstrate a need to refuse the benefit of a favourable assessment and other tax advantages to any heir who acquires by inheritance an agricultural or forestry holding which is not situated within German territory (see, to that effect, with regard to a tax advantage limited to research carried out in the Member State concerned, Case C-39/04 *Laboratoires Fournier* [2005] ECR I-2057, paragraph 23, and, with regard to an exemption from inheritance tax reserved to certain undertakings preserving jobs in the territory of the Member State concerned, Case C-464/05 *Geurts and Vogten* [2007] ECR I-0000, paragraph 27).

52 It should be noted that, in the case in the main proceedings, with regard to the objective of preventing the tax burden from jeopardising the continuation of the activities of agricultural and forestry holdings, and thereby the preservation of the social role of those holdings, there is no evidence in the present case to support a finding that the holdings established in other Member States are not in a comparable situation to that of holdings established in Germany.

53 Finally, in order to justify the national legislation at issue in the main proceedings, the German Government refers to practical difficulties which preclude the transposition of the assessment criteria provided for by the legislation at issue in the main proceedings to agricultural land and forestry assets situated in other Member States. It explains that that assessment procedure is based on standardised values of yield for the different types of holdings concerned and that those values have been derived from statistical documents compiled by the German authorities. Similar data are not available in respect of agricultural land and forestry assets situated in other Member States.

54 In that regard, it should be noted that, while it may indeed prove difficult for national authorities to apply the assessment procedure provided for in Paragraphs 140 to 144 of the BewG to agricultural land and forestry situated in another Member State, that difficulty cannot justify a categorical refusal to grant the tax advantage in question since the taxpayers concerned could be asked themselves to supply the authorities with the data which they consider necessary to ensure application of that procedure in such a way that it is adapted to holdings in other Member States.

55 It should be added that any disadvantages encountered in determining the value of assets situated in the territory of another Member State under a special national procedure cannot, in any event, be sufficient to justify restrictions on the free movement of capital such as those arising under the legislation at issue in the main proceedings, which, apart from that assessment procedure, also reserves application of two other tax advantages to assets situated within German territory (see, to that effect, Case C-334/02 *Commission* v *France* [2004] ECR I-2229, paragraph 29).

56 It must therefore be concluded that, as it has not been established that the national legislation at issue in the main proceedings is justified by overriding reasons in the general interest, Article 73b(1) of the Treaty precludes such legislation.

57 In those circumstances, the answer to the question referred must be that Article 73b(1) of the Treaty, read in conjunction with Article 73d thereof, must be interpreted as precluding legislation of a Member State which, for the purposes of calculating the tax on an inheritance consisting of assets situated in that State and agricultural land and forestry situated in another Member State,

– provides that account be taken of the fair market value of the assets situated in that other Member State, whereas a special valuation procedure exists for identical domestic assets, the results of which amount on average to only 10% of that fair market value, and

– reserves application of a tax-free amount to domestic agricultural land and forestry in relation to those assets and takes account of their remaining value in the amount of only 60% thereof.

**Costs**

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

On those grounds, the Court (Second Chamber) hereby rules:

**Article 73b(1) of the EC Treaty (now Article 56(1) EC), read in conjunction with Article 73d of the EC Treaty (now Article 58 EC), must be interpreted as precluding legislation of a Member**

**State which, for the purposes of calculating the tax on an inheritance consisting of assets situated in that State and agricultural land and forestry situated in another Member State,**

– **provides that account be taken of the fair market value of the assets in that other Member State, whereas a special valuation procedure exists for identical domestic assets, the results of which amount on average to only 10% of that fair market value, and**

– **reserves application of a tax-free amount to domestic agricultural land and forestry in relation to those assets and takes account of their remaining value in the amount of only 60% thereof.**

[Signatures]

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* Language of the case: German.