JUDGMENT OF THE COURT (First Chamber)

17 September 2009 (*)

(Freedom of establishment and free movement of capital – Corporation tax – Acquisition of shares in a capital company – Conditions for taking into account, when determining the acquirer's tax base, the reduction in value of the shares resulting from the dividend distribution)

In Case C-182/08,

REFERENCE for a preliminary ruling under Article 234 EC from the Bundesfinanzhof (Germany), made by decision of 23 January 2008, received at the Court on 30 April 2008, in the proceedings

Glaxo Wellcome GmbH & Co. KG

v

Finanzamt München II,

THE COURT (First Chamber),

composed of P. Jann, President of the Chamber, M. Ilešič, A. Borg Barthet, E. Levits (Rapporteur) and J.-J. Kasel, Judges,

Advocate General: Y. Bot,

Registrar: R. Şereş, Administrator,

having regard to the written procedure and further to the hearing on 2 April 2009,

after considering the observations submitted on behalf of:

– Glaxo Wellcome GmbH & Co KG., by H.-M. Pott and T. Englert, Rechtsanwälte,

– the German Government, by M. Lumma and C. Blaschke, 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 9 July 2009,

gives the following

Judgment

1 This reference for a preliminary ruling relates to the interpretation of Article 52 of the EC Treaty (now, after amendment, Article 43 EC) and Article 73b of the EC Treaty (now Article 56 EC).

2 The reference was made in proceedings between Glaxo Wellcome GmbH & Co. KG, a limited partnership under German law, whose members are limited liability companies, and the Finanzamt München II ('the Finanzamt'), concerning the assessment of its profits for the years 1995 to 1998.

Legal framework

National legislation

3 Under the 'full imputation' taxation system in force in Germany at the material time double economic taxation of the profits distributed by companies established in Germany to German-resident taxpayers was avoided, pursuant to Paragraph 36(2)(3) of the Law on income tax (Einkommensteuergesetz; 'the EstG') and Paragraph 49 of the Law on corporation tax (Körperschaftsteuergesetz; 'the KStG'), by giving those taxpayers the right to offset in full the corporation tax paid by the distributing companies against their own income tax or corporation tax liability.

4 Under Paragraph 36(4)(2) of the EStG, the right to offset corporation tax enjoyed by resident shareholders was converted into a right to a refund to the extent that their own tax debt was lower than the advance corporation tax levied on the sum distributed. It followed from Paragraph 20(1)(3) of the EStG that that right was itself regarded as forming part of the income.

5 If the holding in a legal person formed part of the resident taxpayer's working capital, the taxpayer was entitled, when the dividend was received, to reduce the value of the holding in his tax balance sheet pursuant to Paragraph 6(1)(1) of the EStG. That reduction, the value of a holding as part of a going concern (*Teilwert*), was based on the idea that the distribution simply represented a substitution of assets. Thus, the value of a holding was reduced by the value of the distribution applicable to it.

6 It followed that the gross sum distributed, which included the right under Paragraph 36 of the EStG to offset corporation tax, and the corresponding reduction in value of the holding, were usually the same and cancelled each other out.

7 For that reason, the distributions did not ultimately generate income. Therefore, there was no tax debt corresponding to the tax credit which constituted part of the income generated by the distribution. Accordingly, if the taxpayer did not have any other income in the year in question, that tax credit was converted into a right to a refund.

8 The profit on the sale of shares, being the amount by which the purchase price exceeded their nominal value, constituted income for the purposes of the tax legislation and was liable, in the case of resident taxpayers, to income tax under Paragraph 17 of the EStG or to corporation tax under Article 8(2) of the KStG.

9 With regard to non-resident taxpayers, their income from the distribution of profits of resident companies and the profits arising from the sale of shares in such companies were not liable to German income tax or corporation tax.

10 Non-resident taxpayers were also unable to invoke the application of the full imputation system to the profits distributed to them by resident companies and, therefore, could not obtain a tax credit equal to the tax paid by the resident distributing company.

11 Paragraph 50c(1) and (4) of the EStG, in the version of the Law on the improvement of the taxation

conditions to secure Germany as a business location in the European internal market (Gesetz zur Verbesserung der steuerlichen Bedingungen zur Sicherung des Wirtschaftsstandorts Deutschland im Europäischen Binnenmarkt (Standortsicherungsgesetz), BGBl. 1993 I, p. 1569), provided as follows:

‘(1) A taxpayer with the right to offset corporation tax who acquires shares in a fully taxable capital company … from a shareholder who does not have such a right … may not, when determining profits, take into account reductions in profits arising from

1. inclusion of the lower value as part of a going concern, or

2. the transfer or withdrawal of the holding,

in the year of acquisition or in one of the following nine years, in so far as the inclusion of that lower value or any other reduction in profits is attributable solely to the distribution of profits or to a transfer of profits pursuant to a special control agreement, and the total reduction in profits does not exceed the blocked amount within the meaning of subparagraph 4.

…

4) The blocked amount is the difference between the acquisition costs and the nominal value of the holding. …’

12 The Law of 28 October 1994 amending tax law on company conversions (Gesetz zur Änderung des Umwandlungssteuerrechts, BGBl. 1994 I, p. 3267; ‘the UmwStG’) had made it possible under German law to convert a capital company into a partnership while maintaining the fiscal values of the assets transferred, without creating hidden profits.

13 Under Paragraph 4(4) of the UmwStG, if, as a result of a change in its legal form, the assets of a company were transferred to a partnership, the profit or loss resulting from the acquisition had to be determined, as regards the partnership, by comparing the value at which the assets are to be acquired with the book value of the shares in the transferor company. Under Paragraph 14 of the UmwStG, the same applied where a company was converted into a partnership.

14 The profit or loss resulting from the acquisition thus established (‘first step’) was, under Paragraph 4(5) of the UmwStG, to be increased or reduced by the corporation tax to be set off pursuant to Paragraph 10(1) of the UmwStG and by a blocked amount within the meaning of Paragraph 50c of the EStG, in so far as the shares in the transferor company formed part of the business assets of the transferee partnership on the date of the transfer for tax purposes.

15 If there was still a loss on acquisition (‘second step’), the value of the tangible and intangible assets transferred was to be increased to their going concern value. Any amount still remaining would be applied in reducing the profits of the transferee partnership, under Paragraph 4(6) of the UmwStG.

16 Paragraph 10(1) of the UmwStG provided as follows:

‘The corporation tax chargeable on the parts of the transferor company’s own capital within the meaning of Paragraph 30(1)(1) and (2) of the [KStG] which may be used for the distribution of profits shall, without prejudice to subparagraph 2, be imputed to the income tax or corporation tax payable by the members of the transferee partnership or to the income tax payable by a transferee who is a natural person.’

The Convention between Germany and the United Kingdom

17 Article III of the Convention of 26 November 1964 between the Federal Republic of Germany and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion (BGBl. 1966 II, p. 358) provides that '[t]he industrial or commercial profits of an enterprise of one of the territories shall be subjected to tax only in that territory unless the enterprise carries on a trade or business in the other territory through a permanent establishment situated therein.'

The main proceedings and the question referred for a preliminary ruling

18 The applicant in the main proceedings was formed in the course of the restructuring of the Glaxo Wellcome group, as a result of the conversion by change of legal form, on 1 July 1995, of Glaxo Wellcome GmbH ('GW GmbH'), a limited liability company under German law.

19 The steps in the restructuring of the Glaxo Wellcome group can be described as follows.

20 On 26 June 1995, Glaxo Verwaltungs GmbH ('GV GmbH'), a company formed under German law, which already held 95% of the shares in GW GmbH, acquired from Glaxo Group Limited ('GG Ltd'), its parent company established in the United Kingdom, 5% of the shares in GW GmbH, and became GW GmbH's sole parent company.

21 On 27 June and 7 July 1995, GW GmbH (subsequently the applicant in the main proceedings) acquired all the shares in Wellcome GmbH ('W GmbH'). The companies which sold the shares concerned were GG Ltd, which held 99.98% of the shares in W GmbH, and Burroughs Wellcome Ltd ('W Ltd'), GG Ltd's parent company, which held 0.02% of those shares.

22 By merger agreement of 25 August 1995, W GmbH was merged with retroactive effect to 29 June 1995 into its sole shareholder, GW GmbH.

23 On 30 June 1995, GV GmbH sold 1% of the shares which it held in GW GmbH to Seftonpharm GmbH ('S GmbH'), which was wholly owned by it.

24 On 1 July 1995, GW GmbH was converted into a limited partnership under German law and is now called Glaxo Wellcome GmbH & Co KG.

25 On the day of that conversion, the GW GmbH shares appearing in the balance sheet of GV GmbH (including those in the name of S GmbH) were valued at DEM 500 million. Pursuant to Paragraph 4(4) and (5) of the UmwStG, the applicant in the main proceedings calculated a loss resulting from the acquisition of DEM 328 096 563, taking into account, under Paragraph 50c of the EStG, a blocked amount of DEM 22 887 706 created by the acquisition of 5% of the shares in GW GmbH from GG Ltd.

26 The Finanzamt considered that GV GmbH's acquisition from GG Ltd of the shares in GW GmbH was not the only acquisition to have given rise to a blocked amount in respect of the shares acquired. According to the Finanzamt, the W GmbH shares acquired by the applicant in the main proceedings from GG Ltd and W Ltd were also subject to a blocked amount of DEM 322 565 500. Following the merger of W GmbH into GW GmbH, that second blocked amount did not disappear but was carried over to the shares in GW GmbH held by GV GmbH. According to the Finanzamt, the loss on acquisition resulting from the change in the legal form of GW GmbH therefore fell, when the blocked

amounts were taken into account, to DEM 5 531 063.

27 The applicant in the main proceedings contests the Finanzamt's position, in essence, on the issue whether the loss sustained by GW GmbH on that merger is reduced by a blocked amount, within the meaning of Paragraph 50c of the EStG, resulting from the acquisition by GW GmbH of the shares in W GmbH.

28 Since the applicant was successful in its action before the Finanzgericht München (Finance Court, Munich), the Finanzamt appealed to the Bundesfinanzhof.

29 Unlike the Finanzgericht München, the Bundesfinanzhof considers that, on the basis of German law alone, that loss must be reduced by the blocked amount resulting from the acquisition by GW GmbH of the W GmbH shares.

30 However, according to the Bundesfinanzhof, the lawfulness of the taking into account of a blocked amount under Paragraph 50c of the EStG is not free from doubt under Community law, since the taxpayer is treated differently depending on whether he acquires the shares from a shareholder who is entitled to a tax credit or from one who does not.

31 In those circumstances, the Bundesfinanzhof decided to stay the proceedings and to refer the following question to the Court of Justice for a preliminary ruling:

'Do Article 52 … or 73b of the … Treaty preclude legislation of a Member State which, in the framework of a national imputation system for corporation tax, excludes the reduction in value of shares as a result of a distribution of dividends from the basis of assessment for that tax when a taxpayer who is entitled to a corporation tax credit has acquired shares in a capital company which is fully taxable from a shareholder who is not entitled to such a tax credit whereas, had the shares been acquired from a shareholder who was entitled to a tax credit, such a reduction in value would have reduced the acquirer's basis of assessment?'

The question referred for a preliminary ruling

32 As a preliminary point, it should be noted that, according to the information provided by the German Government, non-resident shareholders had, in principle, only limited tax liability in Germany and did not have the right to offset corporation tax. Consequently, Paragraph 50c of the EStG was principally applicable to the sale of holdings in a capital company which was resident and, therefore, fully taxable in Germany, to a shareholder who was resident in Germany (and, therefore, had the right to offset tax), by a shareholder who was not resident in Germany (and therefore did not have such a right).

33 Therefore, by its question, the Bundesfinanzhof is asking whether Articles 52 or 73b of the Treaty preclude legislation of a Member State under which the reduction in value of shares as a result of a distribution of dividends does not affect the basis of assessment for a resident taxpayer where that taxpayer has acquired shares in a resident capital company from a non-resident shareholder whereas, had those shares been acquired from a resident shareholder, such a reduction in value would have reduced the acquirer's basis of assessment.

34 It must be also be borne in mind that, according to settled case-law, although direct taxation is a competence of the Member States, they must none the less exercise it consistently with Community law (see, inter alia, Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 29; Case C-196/04

Cadbury Schweppes and Cadbury Schweppes Overseas [2006] ECR I-7995, paragraph 40; Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paragraph 36; and Case C-379/05 *Amurta* [2007] ECR I-9569, paragraph 16).

35 Since the national court's question refers both to Article 52 and Article 73b of the Treaty, it must first be determined whether, and if so to what extent, national legislation such as that at issue in the main proceedings is capable of affecting the freedoms guaranteed by those articles.

The freedom in question in the main proceedings

36 In that regard, it should be pointed out that, in order to determine whether national legislation falls within the scope of one or other of the freedoms of movement, it is clear from now well established case-law that the purpose of the legislation concerned must be taken into consideration (see Case C-157/05 *Holböck* [2007] ECR I-4051, paragraph 22 and the case-law cited).

37 It is also clear from the case-law that the Court will in principle examine the measure in dispute in relation to only one of those two freedoms if it appears, in the circumstances of the case, that one of them is entirely secondary in relation to the other and may be considered together with it (Case C-452/04 *Fidium Finanz* [2006] ECR I-9521, paragraph 34).

38 It must therefore be established, first, whether the acquisition, by a resident, of shares in a resident company from a non-resident shareholder, such as that referred to in the main proceedings, amounts to a movement of capital within the meaning of Article 73b of the Treaty.

39 In the absence of a definition in the Treaty of 'movement of capital', the Court has previously recognised the nomenclature annexed to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty (an article repealed by the Treaty of Amsterdam) (OJ 1988 L 178, p. 5) as having indicative value, even though that directive 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), subject to the qualification, contained in the introduction to the nomenclature, that the list set out therein is not exhaustive (see, in particular, Case C-513/03 *van Hilten-van der Heijden* [2006] ECR I-1957, paragraph 39; Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] ECR I-8203, paragraph 22; Case C-11/07 *Eckelkamp* [2008] ECR I-0000, paragraph 38; and Case C-318/07 *Persche* [2009] ECR I-0000, paragraph 24).

40 Movements of capital for the purposes of Article 73b(1) of the Treaty thus include in particular direct investments in the form of participation in an undertaking through the holding of shares which confers the possibility of participating effectively in its management and control ('direct' investments) and the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking ('portfolio' investments) (see, to that effect, Case C-222/97 *Trummerand Mayer* [1999] ECR I-1661, paragraph 21; Case C-483/99 *Commission* v *France* [2002] ECR I-4781, paragraphs 36 and 37; Case C-98/01 *Commission* v *United Kingdom* [2003] ECR I-4641, paragraphs 39 and 40; and Joined Cases C-282/04 and C-283/04 *Commission* v *Netherlands* [2006] ECR I-9141, paragraph 19).

41 The Court has also held that the resale of shares by a non-resident shareholder to the resident issuing company constitutes a capital movement within the meaning of Article 1 of Directive 88/361 and of the nomenclature of capital movements set out in Annex I to that directive (see Case C-265/04 *Bouanich*

[2006] ECR I-923, paragraph 29).

42 According to the fourth indent of the second paragraph of Annex I to Directive 88/361, the free movement of capital covers operations to liquidate or assign assets built up.

43 Thus, the sale of holdings in resident companies by non-resident investors constitutes a capital movement within the meaning of Article 1 of that directive and of the nomenclature of capital movements set out in Annex I to that directive.

44 Consequently, although the acquisition by a resident of shares in a resident company from a non-resident shareholder is not expressly mentioned, as the German Government points out, in the nomenclature of capital movements set out in Annex I to Directive 88/361, that transaction constitutes a capital movement within the meaning of Article 1 of that directive and falls within the scope of the Community rules on the free movement of capital.

45 With regard, second, to Article 52 of the Treaty, it is clear from the case-law of the Court that the freedom of establishment which that article grants to Community nationals and which includes the right for them to take up and pursue activities as self-employed persons and to set up and manage undertakings, under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, entails, for companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Community, the right to exercise their activity in the Member State concerned through a subsidiary, branch or agency (Case C-471/04 *Keller Holding* [2006] ECR I-2107, paragraph 29; *Centro di Musicologia Walter Stauffer*, paragraph 17; and Case C-451/05 *ELISA* [2007] ECR I-8251, paragraph 62).

46 The concept of establishment within the meaning of the Treaty is a very broad one, implying that a Community national may participate, on a stable and continuous basis, in the economic life of a Member State other than his State of origin and profit therefrom, so contributing to economic and social interpenetration within the Community in the sphere of activities as a self-employed person (see, inter alia, *Centro di Musicologia Walter Stauffer*, paragraph 18, and *ELISA*, paragraph 63).

47 According to settled case-law, national provisions which apply to holdings by nationals of a Member State in the capital of a company established in another Member State, giving them definite influence on the company's decisions and allowing them to determine its activities, come within the substantive scope of the provisions of the Treaty on freedom of establishment (see, inter alia, Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22; *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 31; Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paragraph 27; and judgment of 17 July 2008 in Case C-207/07 *Commission* v *Spain*, paragraph 60).

48 According to the observations of the German Government, one of the situations envisaged for the application of the legislation at issue in the main proceedings is that in which a non-resident shareholder controls a number of subsidiaries established in Germany and sells its shares in one of them to another subsidiary controlled by it.

49 It is, however, common ground that the application of that legislation does not depend on the size of the holdings acquired from the non-resident shareholder and is not limited to situations in which the shareholder can exercise definite influence on the decisions of the company concerned and determine its activities.

50 In addition, since the purpose of the legislation at issue in the main proceedings is to prevent non-resident shareholders from obtaining an undue tax advantage directly through the sale of shares with the sole objective of obtaining that advantage, and not with the objective of exercising the freedom of establishment or as a result of exercising that freedom, it must be held that the free movement of capital aspect of that legislation prevails over that of the freedom of establishment.

51 Consequently, even if that legislation has restrictive effects on the freedom of establishment, they are the unavoidable consequence of any restriction on the free movement of capital and, therefore, do not justify an independent examination of that legislation in the light of Article 52 of the Treaty (see, to that effect, Case C-36/02 *Omega* [2004] ECR I-9609, paragraph 27; *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 33; *Test Claimants in the Thin Cap Group Litigation*, paragraph 34; and *Fidium Finanz*, paragraph 48).

52 It follows that the legislation at issue in the main proceedings must be examined exclusively in the light of the free movement of capital.

The existence of a restriction on the free movement of capital

53 As pointed out by the national court, where a resident taxpayer has acquired shares in a resident capital company from a non-resident shareholder, the effect of the legislation at issue in the main proceedings is that the reduction in value of those shares resulting from a distribution of dividends does not affect the acquirer's basis of assessment, whereas, had such shares been acquired from a resident shareholder, that reduction in value would have reduced the acquirer's basis of assessment.

54 That restriction on taking into account the reduction in value of the shares resulting from the dividend distribution applies as from the year of their acquisition and for the next nine years, and concerns only the reductions in profits resulting from a distribution or from the transfer of profits pursuant to a special control agreement, and as long as the reductions in profits do not exceed a certain amount, known as a 'blocked amount'.

55 That blocked amount, which is equal to the difference between the acquisition price paid by the resident shareholder and the nominal value of the shares, thus applies to the shares acquired from a non-resident, effectively annulling the effects of the partial reduction in value of the shares resulting from the distribution of the profits.

56 A taxpayer's right to deduct from his taxable profits the losses relating to the partial reduction in value of the shares held in the company, where the reduction in value of the shares results from the distribution of the profits, undeniably constitutes a tax advantage.

57 The grant of that advantage to a resident taxpayer only where he acquires shares in a resident company from a resident shareholder makes shares held by non-residents less attractive and is, therefore, likely to dissuade the resident taxpayer from acquiring them.

58 In addition, such a difference in treatment is also likely to dissuade non-resident investors from acquiring shares in the resident company and therefore to represent an obstacle to that company's accumulation of capital from other Member States.

59 It follows that legislation such as that at issue in the main proceedings constitutes a restriction on the free movement of capital which is prohibited, in principle, by Article 73b of the Treaty.

The justification for the restriction on the free movement of capital

60 It should however be examined whether such a restriction on the free movement of capital can be justified under the Treaty.

61 According to the German Government and the Commission, the legislation at issue in the main proceedings aims to prevent a non-resident shareholder from obtaining, as a result of certain practices – notably those described by the Advocate General in point 100 of his Opinion – the same result from an economic point of view as if a tax credit had been granted to him.

62 The legislation at issue in the main proceedings thus aims to maintain the coherence of the German full imputation system and is justified, since it follows from the judgment in *Test Claimants in Class IV of the ACT Group Litigation* and from Case C-284/06 *Burda* [2008] ECR I-4571 that the fact that a tax credit intended to prevent double economic taxation is not granted to non-resident shareholders who receive dividends from resident companies cannot be regarded as contrary to Community law.

63 Both the German Government and the Commission contend that the grant of a tax credit, without a corresponding tax debt, to a non-resident shareholder who is not taxable in the Member State in which the distributing company is resident, would in effect oblige that Member State to forgo the taxation of some of the profits generated in its territory. The Commission adds, in that regard, that the payment of a tax credit to a non-resident shareholder would not be consistent with the function of that tax credit, which is to adjust the tax previously charged to the company to the individual rate payable by that taxpayer, but would result only in moving the national tax base to another Member State.

64 The applicant in the main proceedings considers, on the other hand, that the legislation at issue in the main proceedings cannot be justified either by the need to ensure the functioning of the imputation procedure or the need to preserve fiscal coherence or to ensure taxation in Germany alone.

65 It argues that the legislation does not establish any link between how the imputation system works and the penalty resulting from that legislation and, in addition, has the effect of increasing the trade tax payable by the resident acquirer, since the calculation of the profits also determines the amount of that tax, which likewise has no link with the offsetting of corporation tax.

66 With regard to the arguments thus set out by the applicant in the main proceedings, the German Government and the Commission, it should be noted that, pursuant to Article 73d(1)(a) of the EC Treaty (now Article 58(1)(a) EC), the provisions of Article 73b of the Treaty are without prejudice to Member States' right 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.

67 However, Article 73d(1)(a) of the Treaty, which, as a derogation from the fundamental principle of the free movement of capital, must be interpreted strictly, cannot be interpreted as meaning that any tax legislation making a distinction between taxpayers by reference to their place of residence or the Member State in which their capital is invested is automatically compatible with the Treaty. The derogation in Article 73d(1)(a) of the Treaty is itself limited by Article 73d(3) of the Treaty, which provides that the national provisions referred to in Article 73d(1) '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 Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 28; and *Centro di Musicologia Walter Stauffer*, paragraph 31).

68 It is necessary, therefore, to distinguish between the unequal treatment permitted under Article 73d(1)(a) of the Treaty and the discriminatory treatment prohibited by Article 73d(3). It is clear from the case-law that for national tax legislation such as that at issue in the main proceedings to be regarded as compatible with the provisions of the Treaty relating to the free movement of capital the difference in treatment must relate to situations which are not objectively comparable or be justified by an overriding reason in the public interest (see Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 43; *Manninen*, paragraph 29; and C-512/03 *Blanckaert* [2005] ECR I-7685, paragraph 42).

69 The Court has already held that, as regards the application of the tax legislation of the Member State of residence of a company making the distribution which has a system for preventing or mitigating a series of charges to tax or economic double taxation for dividends paid to residents by resident companies, the situation of shareholders resident and receiving dividends in that Member State and of shareholders resident and receiving dividends in another Member State are not necessarily comparable (see, to that effect, *Test Claimants in Class IV of the ACT Group Litigation*, paragraphs 55 and 57).

70 Where the company making the distribution and the shareholder receiving it are not resident in the same Member State, the Member State in which the company making the distribution is resident, that is to say the Member State in which the profits are derived, is not in the same position, as regards the prevention or mitigation of a series of charges to tax and of economic double taxation, as the Member State in which the shareholder receiving the distribution is resident (*Test Claimants in Class IV of the ACT Group Litigation*, paragraph 58).

71 It must however be pointed out that the difference in treatment at issue in the main proceedings does not concern the situation of a shareholder on the basis of his residence or non-residence or, consequently, the possibility of his obtaining a tax credit on the basis of the tax paid by the company distributing the dividends.

72 That difference in treatment concerns only resident shareholders depending on whether they acquired their shares in a resident company from a resident shareholder or from a non-resident shareholder.

73 As pointed out by the Advocate General in point 139 of his Opinion, with regard to the losses resulting from a reduction in value of the shares held in a resident company, those shareholders are in a comparable situation, whether the shares are acquired from a resident or acquired from a non-resident. The distribution of profits reduces the value of a share, whether it was previously acquired from a resident or a non-resident, and in both cases that reduction in value is borne by the resident shareholder.

74 Therefore, such a difference in treatment does not reflect an objective difference in the situations of those shareholders.

75 It must also be determined whether a restriction such as that at issue in the main proceedings can be justified by the overriding reasons in the public interest relied upon by the German Government and by the Commission.

76 The arguments put forward by the German Government and by the Commission, set out in paragraphs 61 to 63 of the present judgment, can be linked to the need to preserve the coherence of the German tax system, to ensure taxation of the revenue generated in German territory and to prevent artificial arrangements whose purpose is to circumvent German legislation.

77 With regard, first, to the argument concerning the need to preserve the coherence of the German tax

system, it should be recalled that the Court has already accepted that the need to preserve the coherence of a tax system may justify a restriction on the exercise of the freedoms of movement guaranteed by the Treaty (Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 28; *Manninen*, paragraph 42; and Case C-418/07 *Papillon* [2008] ECR I-0000, paragraph 43).

78 For an argument based on such a justification to succeed, the Court requires, however, that a direct link be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy, with the direct nature of that link falling to be examined in the light of the objective pursued by the rules in question (see *Papillon*, paragraph 44 and the case-law cited).

79 As pointed out by the German Government and the Commission, the purpose of the legislation at issue in the main proceedings is to prevent the possibility that, by means of an action other than the distribution of dividends, the non-resident shareholder may nevertheless attain the same result from an economic point of view as the obtaining of a tax credit on the corporation tax paid by the company in which he holds the shares.

80 It is common ground that the disadvantages resulting from the legislation at issue in the main proceedings are suffered directly by the resident shareholder who has acquired those shares from a non-resident. For that resident shareholder, the impossibility of deducting from his taxable profits the losses related to the reduction in the value of the shares held in the resident company, where the reduction in value of the shares results from the distribution of the profits, is not offset by any tax advantage. The argument that the profit made by the non-resident who has sold the shares to the resident shareholder is not subject to taxation in Germany is irrelevant with regard to the resident shareholder who suffers the disadvantage.

81 Consequently, the direct link required by the case-law cited in paragraph 78 above is lacking in the present case and the legislation at issue in the main proceedings cannot be justified by the need to preserve the coherence of the full imputation taxation system.

82 With regard to the argument concerning the need to maintain the Federal Republic of Germany's ability to exercise its tax jurisdiction in relation to activities carried out in its territory, it must be pointed out that, while it has been consistently held in the case-law that a reduction in tax revenue cannot be regarded as an overriding reason in the public interest which may be relied on to justify a measure which is, in principle, contrary to a fundamental freedom (see, inter alia, *Manninen*, paragraph 49 and the case-law cited), the Court has also accepted that there may be some conduct which is capable of undermining the Member States' right to exercise their tax jurisdiction in relation to the activities carried out in their territory and thus of jeopardising a balanced allocation of the power to impose taxes between the Member States (see *Marks & Spencer*, paragraph 46) which can justify a restriction on the freedoms secured by the Treaty (see, to that effect, *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraphs 55 and 56; and Case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647, paragraph 42).

83 The Court has also held that to require the Member State in which the company making the distribution is resident to ensure that profits distributed to a non-resident shareholder are not liable to a series of charges to tax or to economic double taxation, either by exempting those profits from tax at the level of the company making the distribution or by granting the shareholder a tax advantage equal to the tax paid on those profits by the company making the distribution, would mean in point of fact that that State would be obliged to abandon its right to tax a profit generated by an economic activity undertaken on its territory (*Test Claimants in Class IV of the ACT Group Litigation*, paragraph 59).

84 Transactions other than the distribution of dividends, which allow the non-resident shareholder to obtain the same result from an economic point of view as if he had been granted the tax credit in respect of the corporation tax paid by the company in which he holds the shares, could equally undermine the ability of the Member State where that company resides to exercise its right to tax a profit generated by an economic activity undertaken in its territory.

85 The inclusion in the sales price of those shares of an amount equal to the tax credit which the resident acquirer of the shares will be able to receive and the offsetting of the reduction in value of those shares, following the distribution of dividends, against the amount of dividends received by the acquirer of those shares, would lead, for that resident acquirer, either to the right to offset the tax credit against other taxes due by him or, if he has no other taxable income, to a refund of an amount equal to the tax credit for the tax on the profits paid by the company.

86 Since the price of the shares includes an amount equal to the tax credit, the grant of a tax credit or the refund of an amount equal to that tax credit to the new resident shareholder would result in indirectly granting the non-resident shareholder a tax credit for the tax charged to the company.

87 Such consequences would not just reduce the Federal Republic of Germany's tax revenues but would mean that, by indirectly granting the non-resident a financial advantage equal to the tax credit for the tax charged on the profits of a resident company, the profits normally taxable in that company's Member State of residence would be transferred to the Member State with jurisdiction to tax the profits made by the non-resident, thus jeopardising a balanced allocation of the power to impose taxes between the Member States.

88 It follows that legislation such as that at issue in the main proceedings can be justified by the need to maintain a balanced allocation of the power to impose taxes between the Member States.

89 With regard, finally, to the arguments concerning the need to prevent tax avoidance and to combat artificial arrangements designed to circumvent the German tax system, it must be held that a national measure restricting the free movement of capital can be justified where it specifically targets wholly artificial arrangements which do not reflect economic reality and whose only purpose is to obtain a tax advantage (see, to that effect, *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraphs 51 and 55; *Test Claimants in the Thin Cap Group Litigation*, paragraphs 72 and 74; and Case C-330/07 *Jobra* [2008] ECR I-0000, paragraph 35).

90 In the case in the main proceedings, as follows from the observations of the German Government, confirmed by the statement of reasons for the law which introduced into the German legal system the rules at issue in the main proceedings, the aim of the legislation is to thwart arrangements pursuant to which non-resident shareholders obtain, on the sale of those shares, an amount equal to the tax credit for the corporation tax paid by the resident company, by adopting practices such as those described in point 100 of the Advocate General's Opinion, carried out with the sole objective of obtaining such a fiscal advantage.

91 By restricting the right of the new shareholder to deduct from his taxable profits the losses resulting from the reduction in value of the shares concerned, to the extent that they do not exceed the 'blocked amount', the legislation at issue in the main proceedings is capable of preventing practices which have no objective other than to obtain for the non-resident shareholder a tax credit for the corporation tax paid by the resident company. In addition, the increase in the basis of assessment of the new shareholder as a result of that limitation is designed to ensure that profits which would usually be taxed

in Germany are not transferred, as part of the profit made by the non-resident former shareholder equal to the undue tax credit, without being taxed in Germany.

92 Consequently, such legislation is capable of achieving the objective of maintaining a balanced allocation of the power to impose taxes between the Member States and of preventing wholly artificial arrangements which do not reflect economic reality and whose only purpose is to obtain a tax advantage.

93 Nevertheless, it is necessary to establish that such legislation does not go beyond what is necessary to attain the objectives thus pursued.

94 It is for the national court to determine whether, to the extent that the calculation of the blocked amount is based on the acquisition costs of the shares concerned, the consequences of the legislation at issue in the main proceedings exceed what is necessary to ensure that a sum equal to the tax credit is not unduly granted to the non-resident shareholder.

95 That legislation applies, as the Advocate General has also stated in point 170 of his Opinion, where a resident taxpayer has acquired his shares in a resident company from a non-resident shareholder at a price which, for whatever reason, exceeds their nominal value.

96 Therefore, such legislation is based on an assumption that any increase in the selling price necessarily takes account of the tax credit and is made solely for that reason. As stated by the Advocate General in point 172 of his Opinion, it cannot be excluded that the shares were sold at more than their nominal value for reasons other than in order to obtain for the shareholder a tax credit for the corporation tax paid by the resident company or, in any case, that the undistributed profits and the possibility of obtaining a tax credit relating to those shares constitute only one element of their selling price.

97 In addition, the applicant in the main proceedings has claimed before the Court that the taking into account of the blocked amount and the increase in the resident shareholder’s basis of assessment also have consequences for other taxes levied on the shareholder and, in particular, for the trade tax payable by him. It claims that those consequences go beyond what is necessary to attain the objectives pursued by the legislation at issue in the main proceedings.

98 It is also for the national court to establish whether the restriction on taking into account the reduction in value of the shares resulting from the distribution of the dividends as from the year of acquisition of those shares and during the following nine years does not exceed what is necessary to attain the objectives pursued by the legislation at issue in the main proceedings.

99 Finally, with regard to the objective of preventing wholly artificial arrangements which do not reflect economic reality and whose only purpose is unduly to obtain a tax advantage, it must be pointed out, as the Advocate General stated in point 174 of his Opinion, that in order to comply with the principle of proportionality a measure pursuing such an objective must enable the national court to carry out a case-by-case examination, taking into account the particular features of each case, based on objective elements, in order to assess the abusive or fraudulent conduct of the persons concerned.

100 To the extent that the application of legislation such as that at issue in the main proceedings cannot be limited to wholly artificial arrangements, established on the basis of objective elements, but covers all cases in which a resident taxpayer has acquired shares in a resident company from a non-resident shareholder at a price which, for whatever reason, exceeds the nominal value of those shares, the effects

of such legislation exceed what is necessary in order to attain the objective of preventing wholly artificial arrangements which do not reflect economic reality and whose only purpose is unduly to obtain a tax advantage.

101 The answer to the question referred is therefore that Article 73b of the Treaty must be interpreted as not precluding legislation of a Member State which excludes the reduction in value of shares as a result of the distribution of dividends from the basis of assessment for a resident taxpayer, where that taxpayer has acquired shares in a resident capital company from a non-resident shareholder, whereas, had the shares been acquired from a resident shareholder, such a reduction in value would have reduced the acquirer's basis of assessment.

102 This applies in cases where such legislation does not exceed what is necessary to maintain a balanced allocation of the power to impose taxes between the Member States and to prevent wholly artificial arrangements which do not reflect economic reality and whose only purpose is unduly to obtain a tax advantage. It is for the national court to examine whether the legislation at issue in the main proceedings is limited to what is necessary in order to attain those objectives.

Costs

103 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 (First Chamber) hereby rules:

Article 73b of the EC Treaty (now Article 56 EC) must be interpreted as not precluding legislation of a Member State which excludes the reduction in value of shares as a result of the distribution of dividends from the basis of assessment for a resident taxpayer, where that taxpayer has acquired shares in a resident capital company from a non-resident shareholder, whereas, had the shares been acquired from a resident shareholder, such a reduction in value would have reduced the acquirer's basis of assessment.

This applies in cases where such legislation does not exceed what is necessary to maintain a balanced allocation of the power to impose taxes between the Member States and to prevent wholly artificial arrangements which do not reflect economic reality and whose only purpose is unduly to obtain a tax advantage. It is for the national court to examine whether the legislation at issue in the main proceedings is limited to what is necessary in order to attain those objectives.

[Signatures]

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* Language of the case: German.