JUDGMENT OF THE COURT (First Chamber)

3 June 2010 (*)

(Failure of a Member State to fulfil obligations – Free movement of capital – Articles 56 EC and 40 of the EEA Agreement – Difference in treatment – Dividends distributed to resident and non-resident companies)

In Case C-487/08,

ACTION under Article 226 EC for failure to fulfil obligations, brought on 11 November 2008,

European Commission, represented by R. Lyal and I. Martinez del Peral, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Kingdom of Spain, represented by N. Díaz Abad, acting as Agent,

defendant,

THE COURT (First Chamber),

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

Advocate General: J. Mazák,

Registrar: R. Grass,

having regard to the written procedure,

having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,

gives the following

Judgment

1 By its application, the Commission of the European Communities seeks a declaration from the Court that, by applying different treatment to dividends distributed to resident and non-resident shareholders, the Kingdom of Spain has failed to fulfil its obligations under Article 56 EC and Article 40 of the Agreement on the European Economic Area of 2 May 1992 (OJ 1994 L 1, p.3) ('the EEA Agreement').

Legal background

EEA Agreement

2 Article 40 of the EEA Agreement provides:

‘Within the framework of the provisions of this Agreement, there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in [the European Community] Member States or [the European Free Trade Association (EFTA)] States and no discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested. Annex XII contains the provisions necessary to implement this Article.’

European Union law

3 Under Article 4(1) of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225, p. 6), as amended by Council Directive 2003/123/EC of 22 December 2003 (OJ 2004 L 7, p. 41) (‘Directive 90/435’), provides:

‘Where a parent company or its permanent establishment, by virtue of the association of the parent company with its subsidiary, receives distributed profits, the State of the parent company and the State of its permanent establishment shall, except when the subsidiary is liquidated, either:

– refrain from taxing such profits, or

– tax such profits while authorising the parent company and the permanent establishment to deduct from the amount of tax due that fraction of the corporation tax related to those profits and paid by the subsidiary and any lower-tier subsidiary, subject to the condition that at each tier a company and its lower-tier subsidiary meet the requirements provided for in Articles 2 and 3, up to the limit of the amount of the corresponding tax due.’

4 Article 5 of Directive 90/435 provides:

‘Profits which a subsidiary distributes to its parent company shall be exempt from withholding tax.’

National legislation

5 According to Article 30(2) of the consolidated Law on corporation tax (Ley del Impuesto sobre Sociedades), adopted by Royal Decree-Law 4/2004 of 5 March 2004 (BOE No 61 of 11 March 2004, p. 10951), (‘the Law on corporation tax’), a resident company which, for a continuous period of at least one year, has a direct or indirect shareholding of 5% or more in the capital of another resident company may deduct from its taxable income the whole amount of the gross dividend received.

6 The dividends referred to in Article 30(2) of the Law on corporation tax are exempt from the deduction at source, in accordance with Article 140(4)(d) of that law.

7 Article 14(1) of the consolidated Law on the tax on the income of non-residents (Texto Refundido de la Ley del Impuesto sobre la Renta de no Residentes), adopted by Royal Decree-Law No 5/2004 of 5 March 2004 (BOE No 62 of 12 March 2004, p. 11176, ‘the Law on the tax on the income of non-residents’), provides as follows:

‘The following income is exempt:

…

(h) Profits distributed by subsidiaries resident in Spain to their parent companies resident in other Member States of the European Union or to other permanent establishments situated in other Member States, where the following conditions are fulfilled:

1. The parent company and the subsidiary are subject, in a Member State of the European Union, to one of the taxes on profits of legal persons mentioned in Article 2[(1)(c)] of Directive 90/435 … and which are not exempt, in the State in which they are situated.

2. The distribution of profits does not result from the liquidation of the subsidiary company.

3. The parent and subsidiary companies take one of the forms listed in the annex to Directive 90/435 …

"Parent company" means a company which has a direct shareholding of at least 20% in another company, the second company being therefore regarded as the subsidiary of the first. That percentage shall be reduced to 15% from 1 January 2007 and to 10% from 1 January 2009.

The aforementioned shareholding must have been held without interruption for one year preceding the day on which the distributed profits fall due. If not, it must be retained throughout the period necessary to complete the one year required. In the latter case, the tax levied is repaid when the required retention period has elapsed.

…

Notwithstanding the foregoing, the Minister for the Economy and Finance may declare, subject to reciprocity, that subparagraph (h) applies to subsidiary companies which take a legal form other than those provided for in the annex to Directive [90/435] and to the profits distributed to a parent company which has a direct shareholding of at least 10% in a subsidiary company resident in Spain, so long as the other conditions set out in subparagraph (h) are satisfied.'

8 Other non-resident companies having a shareholding in a resident company are subject to tax on dividends paid by the latter.

Pre-litigation procedure

9 On 18 October 2005, the Commission sent to the Kingdom of Spain a letter of formal notice stating that, in so far as the relevant Spanish legislation requires non-resident companies to have a higher shareholding threshold than that imposed on resident companies, in order to benefit from the tax exemption on dividends, it might be incompatible with Article 56 EC and Article 40 of the EEA Agreement.

10 The Kingdom of Spain replied by letter of 3 January 2006, submitting, in particular, that it is incumbent on the Member State of residence to prevent economic double taxation, and that the relevant Spanish legislation does not add to the tax burden on dividends distributed to non-resident companies since, in order to assess the tax burden on an investment, account must be taken of the definitive taxation of the transaction as a whole.

11 Since the Commission did not regard the Kingdom of Spain's reply as satisfactory, it sent a reasoned opinion to that Member State on 13 July 2006, requesting that the necessary measures for compliance be taken within a period of two months from the date of receipt of the opinion.

12 The Kingdom of Spain replied to that opinion by letter of 4 October 2006, denying any discrimination or restriction on the free movement of capital. The Commission, not being satisfied with such a reply, decided to bring the present proceedings.

The action

Arguments of the parties

13 The Commission submits that, by making the exemption on dividends distributed by companies resident in Spain subject to a shareholding threshold for recipient companies which is higher for non-resident recipient companies, namely, 20%, than for resident recipient companies, namely, 5%, the relevant Spanish legislation infringes Article 56 EC and Article 40 of the EEA Agreement.

14 The Kingdom of Spain operates a discriminatory difference in treatment between non-resident and resident companies. If the shareholding of the resident recipient company in the distributing company reaches 5%, dividends distributed to it are exempted from tax, whereas, in the case of a non-resident recipient company, the exemption applies only where the shareholding threshold of 20% is reached.

15 According to the Commission, the case-law deriving from the judgment in Case C-379/05 *Amurta* [2007] ECR I-9569, in which the Court held that, as regards shareholdings not covered by Directive 90/435, Articles 56 EC and 58 EC preclude the application of a withholding tax on dividends distributed to non-resident companies while exempting from that tax the dividends paid to resident companies, is clearly transposable to the situation which is the subject of the present proceedings and is sufficient to found the latter.

16 In addition, such a difference in treatment might dissuade non-resident investors from investing in the shareholdings of companies which are resident in Spain, even if they were able to benefit from the deductions provided for by the national law of their State or a convention for the avoidance of double taxation.

17 Although the Court held in *Amurta*, that it cannot be excluded that a Member State may succeed in ensuring compliance with its obligations under the EC Treaty through the conclusion of a convention for the avoidance of double taxation with another Member State, it is, in the Commission's view, clear from the judgment of the EFTA Court in Case E-1/04 *Fokus Bank* EFTA Court Report [2004] p. 15, paragraphs 37 and 38, that the State of the source of the income cannot justify discriminatory treatment, even by concluding an agreement which grants a tax advantage in the Member State of residence. A Member State cannot shift its obligation to comply with the obligations imposed on it by the Treaty to another Member State and rely on the other State to make good the discrimination.

18 Even if it is conceded that a convention for the avoidance of double taxation is able to neutralise unfavourable treatment by a Member State, such neutralisation does not occur in the present case. The conventions concluded by the Kingdom of Spain do not guarantee the recovery of all the tax paid in that Member State, in particular because of the exemption frequently applied by the State of residence of the recipient company to dividends in general or to those from other Member States, making it

impossible to recover all the tax paid in Spain.

19 In any event, a Member State cannot rely on the existence of a tax advantage granted unilaterally by another Member State in order to escape its obligations under the Treaty (*Amurta*, paragraph 78). Therefore, the Kingdom of Spain cannot in any circumstances rely on the exemption of dividends in other Member States granted unilaterally by the Republic of Cyprus, because the Kingdom of Spain has not concluded a double taxation agreement with that Member State.

20 Nor can the Kingdom of Spain rely on the argument that it is for the State of residence to eliminate legal double taxation. While the powers of the State of the source of the income must be distinguished from those of the State of residence, neither State may exercise that competence in a discriminatory manner.

21 The Kingdom of Spain denies the alleged failure to fulfil its obligations under Article 56 EC and Article 40 of the EEA Agreement.

22 The Kingdom of Spain contends, firstly, that the situations governed by Article 14(1)(h) of the Law on the tax on the income of non-residents, applicable to the distribution of dividends by companies resident in Spain to companies resident in another Member State, and Articles 30(2) and 140(4)(d) of the Law on corporation tax, applicable to dividends distributed between companies residing in Spain, are not comparable.

23 Although, with respect to dividends distributed to companies resident in Spain, Article 30(2) in conjunction with Article 140(4)(d) of the Law on corporation tax are intended to avoid domestic double taxation, it is not for the Kingdom of Spain, as the Member State in which the income is generated and which, in accordance with generally accepted rules of international tax law, has taxation priority, to avoid international double taxation of dividends paid to non-resident companies. That task is for the State of residence of the company receiving the dividends.

24 The Court has confirmed, in particular, in the judgments in Case C‑374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I‑11673, paragraph 58, and Case C‑282/07 *Truck Center* [2008] ECR I‑10767, paragraph 42, the distinction between the powers of the State of residence of the recipient company and those of the State of the source of the income. Similarly, Article 4(1) of Directive 90/435 requires the Member State of residence of the parent company which receives the profits distributed by a subsidiary resident in another Member State to prevent double taxation.

25 Secondly, the Kingdom of Spain states that the relevant Spanish legislation does not lead to unfavourable treatment of non-resident companies because the definitive taxation of the transaction as a whole must be considered. That involves taking account of the tax paid on dividends in the tax payable in the State of residence of the recipient company as well as the procedure for eliminating double taxation. Even if the Spanish legislation granted identical tax treatment to the dividends received by resident and non-resident companies, it would impossible to guarantee that the definitive taxation would be the same. Therefore, the relevant Spanish legislation does not by itself lead to the higher taxation of dividends paid to non-resident companies and does not subject the latter to discriminatory treatment.

26 In addition, because the Kingdom of Spain wishes to avoid a series of charges to tax on dividends received by resident companies by means of an exemption, it has also provided for the same advantage in conventions for the avoidance of double taxation concluded by it with respect to the dividends

received by non-resident companies. The Kingdom of Spain has concluded agreements for the avoidance of double taxation by means of a method of deduction, which, at the end of the period laid down in the reasoned opinion, were in force in all the Member States, with the exception of the Republic of Cyprus, and in all the EFTA States with which information exchanges exist.

27 Although a convention for the avoidance of double taxation, such as that concluded with the Kingdom of the Netherlands, does not enable the tax levied in the Kingdom of Spain to be offset, since the Kingdom of the Netherlands has put in place an exemption scheme for dividends, that results from the exercise in parallel by two Member States of their fiscal sovereignty. In accordance with the case-law of the Court, the adverse consequences arising from the disparities between the rules of the Member States cannot be criticised for that reason by the law of the European Union (Case C-513/04 *Kerckhaert and Morres* [2006] ECR I-10967, paragraph 20, and Case C-298/05 *Columbus Container Services* [2007] ECR I-10451, paragraph 43).

28 So far as concerns the Republic of Cyprus, with which the negotiations on the conclusion of a convention for the avoidance of double taxation are at an advanced stage, the Kingdom of Spain provides in its domestic law for a general exemption for dividends from other Member States, so that double taxation does not occur.

29 Thirdly, the case-law resulting from the judgments in *Amurta* and *Fokus Bank*, is not applicable in the present case in the manner alleged by the Commission.

30 As regards *Amurta*, it is clear from paragraphs 79 and 80 thereof that, in spite of a difference in treatment, there is no restriction on the free movement of capital where the effects of the taxation of dividends by the State of the source of the income are neutralised in the State of residence of the recipient company. The procedures contained in the conventions for the avoidance of double taxation concluded by the Kingdom of Spain neutralise the effects of the taxation of dividends by Spain and should not be treated as actual or potential tax advantages in other Member States.

31 Nor can it be asserted that the conclusion of a convention for the avoidance of double taxation involves transferring to the Member State which is the other party to the convention the obligation to comply with the obligations laid down by the Treaty, for it is an agreement between two Member States concerning the allocation of their respective powers of taxation aiming to eliminate double taxation. It is for the Member States to take the measures necessary to avoid double taxation by applying, in particular, the apportionment criteria followed in international tax practice.

32 As regards the judgment in *Fokus Bank*, cited above, it is not to be read as indicating that the source State cannot, in principle, rely on the provisions of a convention for the avoidance of double taxation in order to reduce the double taxation for which it is responsible, such a reading being contrary to the case-law of the Court and, in particular, in *Amurta*, on which the Commission has based its action.

33 Fourthly, the refusal to take account of conventions for the avoidance of double taxation would compromise the tax sovereignty of the Kingdom of Spain with respect to the taxation of dividends distributed to non-residents.

Findings of the Court

34 As a preliminary point, it must be observed that, according to consistent case-law, the question whether a Member State has failed to fulfil its obligations must be determined by reference to the situation

obtaining in the Member State at the end of the period laid down in the reasoned opinion (see, inter alia, Case C-173/01 *Commission* v *Greece* [2002] ECR I-6129, paragraph 7; Case C-519/03 *Commission* v *Luxembourg* [2005] ECR I-3067, paragraph 18; and Case C-562/07 *Commission* v *Spain* [2009] ECR I-0000, paragraph 23).

35 In the present case, that period expired two months after the receipt by the Kingdom of Spain of the reasoned opinion sent to it on 13 July 2006 and, in accordance with settled case-law, subsequent changes cannot be taken into account by the Court (see, in particular, Case C-135/03 *Commission* v *Spain* [2005] ECR I-6909, paragraph 31).

36 Therefore, the fact that, in accordance with the second subparagraph of Article 14(1)(h)(3) of the Law on the tax on the income of non-residents, the percentage of the shareholding required in the distributing company was reduced to 15% from 1 January 2007 and to 10% from 1 January 2009 is not relevant in this case.

Infringement of Article 56(1) EC

37 According to settled case-law, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with European Union law (see, inter alia, *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 36; *Amurta*, cited above, paragraph 16; and Case C-540/07 *Commission* v *Italy* [2009] ECR I-0000, paragraph 28).

38 It must also be noted that, in the absence of any unifying or harmonising measures at European Union level, Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation (Case C-336/96 *Gilly* [1998] ECR I-2793, paragraphs 24 and 30; Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 57; *Amurta*, paragraph 17; and *Commission* v *Italy*, paragraph 29).

39 As appears particularly from the third recital in the preamble to Directive 90/435, the aim of that directive is, by the introduction of a common system of taxation, to eliminate any disadvantage to cooperation between companies of different Member States as compared with cooperation between companies of the same Member State and thereby to facilitate the grouping together of companies at European Union level (Case C-294/99 *Athinaïki Zithopiïa* [2001] ECR I-6797, paragraph 25; Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, paragraph 103; and *Amurta*, paragraph 18).

40 In respect of shareholdings not covered by Directive 90/435, it is for the Member States to determine whether, and to what extent, economic double taxation or a series of charges to tax on distributed profits is to be avoided and, for that purpose, to establish, either unilaterally or through double taxation conventions concluded with other Member States, procedures intended to prevent or mitigate such economic double taxation or series of charges to tax. However, this does not of itself mean that the Member States are entitled to impose measures that contravene the freedoms of movement guaranteed by the Treaty (see, *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 54; *Amurta*, paragraph 24; and *Commission* v *Italy*, cited above, paragraph 31).

41 In this case, in accordance with Article 30(2) of the Law on corporation tax, the dividends distributed by a company resident in Spain to another company resident in Spain which has held, for a continuous period of at least one year, a direct or indirect shareholding of 5% or more in the distributing company

may be deducted in full from the taxable income of the recipient company and are, in addition, exempt from withholding tax, in accordance with Article 140(4)(d) of the Law on corporation tax. However, as regards the dividends distributed by a company resident in Spain to a company resident in another Member State, they are exempt, in accordance with Article 14(1) of the Law on the tax on the income of non-residents, only where the recipient company had a direct shareholding in the distributing company of at least 20%.

42 Therefore, it must be observed that, as regards recipient companies having between 5% and 20% of the shareholding in the distributing company, the relevant Spanish legislation operates a difference in treatment between recipient companies resident in Spain and recipient companies resident in another Member State, only the dividends paid to the former being exempt from tax.

43 Such a difference in treatment is capable of to dissuading companies established in other Member States from investing in Spain and therefore constitutes a restriction on the free movement of capital, prohibited, in principle, by Article 56(1) EC.

44 It needs to be examined, however, whether that restriction on the free movement of capital may be justified, having regard to the provisions of the Treaty.

45 According to Article 58(1) EC, ‘Article 56 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 their place of residence …’

46 It must also be noted that the derogation laid down in Article 58(1)(a) EC is itself limited by Article 58(3) EC, which provides that the national provisions referred to in Article 58(1) EC ‘shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56’.

47 The differences in treatment authorised by Article 58(1)(a) EC must thus be distinguished from the forms of discrimination prohibited by Article 58(3) EC. The case-law of the Court shows that in order, for national tax legislation such as that at issue here to be capable of being regarded as 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 an overriding reason relating to the public interest (Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 43; Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 29; *Amurta*, paragraph 32; and *Commission* v *Italy*, paragraph 49).

48 It therefore needs to be established whether, having regard to the objective of the national legislation at issue, companies receiving dividends which are resident in Spain and those established in another Member State are in comparable situations.

49 The Kingdom of Spain contends that the objective of the relevant national legislation applicable to companies resident in Spain is to prevent double taxation. With respect to such an objective, companies resident in another Member State are not in a comparable situation, because the prevention of double taxation of dividends paid to those companies is not incumbent on the Kingdom of Spain, as the State of the source of the income, but on the State of residence of those companies.

50 It is to be borne in mind that the Court has already held that, in the context of measures laid down by a Member State in order to prevent or mitigate the imposition of a series of charges to tax on, or the economic double taxation of, profits distributed by a resident company, resident shareholders receiving

dividends are not necessarily in a situation which is comparable to that of shareholders receiving dividends who are resident in another Member State (Case C‑170/05 *Denkavit Internationaal and Denkavit France* [2006] ECR I‑11949, paragraph 34; *Amurta*, paragraph 37; and *Commission* v *Italy*, cited above, paragraph 51).

51 However, as soon as a Member State, either unilaterally or by way of a convention, imposes a charge to tax on the income, not only of resident shareholders, but also of non-resident shareholders, from dividends which they receive from a resident company, the situation of those non-resident shareholders becomes comparable to that of resident shareholders (*Test Claimants in Class IV of the ACT Group Litigation*, paragraph 68; *Denkavit Internationaal and Denkavit France*, paragraph 35; *Amurta*, paragraph 38; and *Commission* v *Italy*, paragraph 52).

52 It is solely because of the exercise by that State of its power of taxation that, irrespective of any taxation in another Member State, a risk of a series of charges to tax or economic double taxation may arise. In such a case, in order for non-resident companies receiving dividends not to be subject to a restriction on the free movement of capital prohibited, in principle, by Article 56 EC, the State in which the company making the distribution is resident is obliged to ensure that, under the procedures laid down by its national law in order to prevent or mitigate a series of liabilities to tax or economic double taxation, non-resident shareholder companies are subject to the same treatment as resident shareholder companies (*Test Claimants in Class IV of the ACT Group Litigation*, paragraph 70; *Amurta*, paragraph 39; and *Commission* v *Italy*, paragraph 53).

53 It must, in the circumstances of this case, be stated that the Kingdom of Spain chose to exercise its power of taxation over dividends distributed to companies established in other Member States. Non-resident recipients of those dividends thus find themselves in a situation comparable to that of resident companies as regards the risk of economic double taxation of dividends distributed by resident companies, so that non-resident recipients cannot be treated differently from resident recipients.

54 In that regard, the reference by the Kingdom of Spain to the judgment in *Truck Center* is irrelevant. The difference in treatment between companies receiving income from capital, established by the legislation at issue in the main proceedings which gave rise to that judgment, consisted in the application of different taxation arrangements to companies established in Belgium and to those established in another Member State (*Truck Center*, paragraph 41). However, under the legislation at issue in the present case, the dividends paid to companies resident in another Member State are taxed, whereas the dividends paid to companies resident in Spain are exempt.

55 The Kingdom of Spain also submits that the relevant Spanish legislation does not lead to unfavourable treatment of companies resident in another Member State, for account must be taken of the treatment of the dividends received in the Member State of residence of the recipient company. First, it is clear that any greater tax burden imposed on dividends paid to non-resident companies is not attributable solely to the Kingdom of Spain, but stems from the parallel exercise of the power of taxation by the Kingdom of Spain and the Member State of residence of the recipient company. Second, the method of deduction established by the conventions to avoid double taxation concluded by the Kingdom of Spain prevent a series of charges to tax similar to the exemption applicable to the dividends distributed to companies resident in Spain.

56 On the first point, the Court has already ruled that the disadvantages which could arise from the parallel exercise of powers of taxation by different Member States, to the extent that such an exercise is

not discriminatory, do not constitute restrictions prohibited by the Treaty (see, to that effect, *Kerckhaert and Morres*, paragraphs 19, 20 and 24; Case C-194/06 *Orange European Smallcap Fund* [2008] ECR I-3747, paragraphs 41, 42 and 47; and Case C-128/08 *Damseaux* [2009] ECR I-0000, paragraph 27).

57 However, in the present case, as was held in paragraph 53 of this judgment, the unfavourable treatment of the dividends distributed to recipient companies resident in another Member State arises solely from the exercise by the Kingdom of Spain of its power of taxation and is, therefore, attributable to it.

58 As regards the second point, it is true that the Court has held that the possibility cannot be excluded that a Member State might succeed in ensuring compliance with its obligations under the Treaty by concluding a convention for the avoidance of double taxation with another Member State (see, to that effect, *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 71; *Amurta*, paragraph 79; and *Commission* v *Italy*, paragraph 36).

59 However, it is necessary for that purpose that application of such a convention should allow the effects of the difference in treatment under national legislation to be compensated for. Thus, the Court has held that the difference in treatment between dividends distributed to companies established in other Member States and those distributed to resident companies does not disappear unless the tax withheld at source under national legislation can be set off against the tax due in the other Member State in the full amount of the difference in treatment arising under the national legislation (see, *Commission* v *Italy*, cited above, paragraph 37).

60 In order to attain the objective of neutralisation, the application of the method of deduction relied on by the Kingdom of Spain should therefore enable the tax on dividends levied by that Member State to be deducted in its entirety from the tax due in the Member State of residence of the recipient company, so that if the dividends received by that company were ultimately taxed more heavily than the dividends paid to companies resident in Spain, that heavier tax burden could no longer be attributed to the Kingdom of Spain, but to the State of residence of the company receiving dividends which exercised its power to impose taxes.

61 In the present case, the majority of the conventions for the avoidance of double taxation concluded by the Kingdom of Spain provide that the amount deducted or set off in respect of tax withheld in Spain cannot exceed the fraction of the tax in the Member State of residence paid by the recipient company, calculated before the deduction, corresponding to taxable income in Spain.

62 Therefore, the difference in treatment may be neutralised only where the dividends from Spain are sufficiently taxed in the other Member State. If those dividends are not taxed, or are not sufficiently taxed, the sum withheld in Spain or a part thereof cannot be deducted. In that case, the difference in treatment arising from the application of national legislation cannot be compensated for by applying provisions of the double taxation convention (see, *Commission* v *Italy*, paragraph 38).

63 That finding applies even where the conventions for the avoidance of double taxation concluded by the Kingdom of Spain do not provide for the deduction to be limited to the fraction of the tax in the Member State of residence paid by the company receiving dividends, calculated before the deduction, corresponding to income taxable in Spain, but provide that the tax levied in Spain is to be deducted from the tax relating to that income in the Member State of residence. If those dividends are not taxed or are not sufficiently taxed, the sum withheld in Spain or a part thereof cannot be deducted.

64 The choice as to whether to tax income from Spain in the other Member State or the level at which it is

to be taxed, depends not on the Kingdom of Spain but on the tax rules laid down by the other Member State. The Kingdom of Spain is therefore wrong to argue that deduction of the tax withheld at source in Spain against the tax due in the other Member State, pursuant to the provisions of conventions for the avoidance of double taxation, allows in all cases for the difference in treatment arising from the application of national legislation to be neutralised (see, *Commission* v *Italy*, paragraph 39).

65 The Kingdom of Spain also stated that it has not yet concluded a convention for the avoidance of double taxation with the Republic of Cyprus, but it provides in its domestic law for a general exemption on dividends from other Member States, so that double taxation does not occur.

66 First, a Member State cannot rely on the existence of a tax advantage granted unilaterally by another Member State in order to escape its obligations under the Treaty (*Amurta*, cited above, paragraph 78). Second, in the present case, an exemption such as that granted by the Republic of Cyprus cannot in any event neutralise the double taxation arising from the exercise by the Kingdom of Spain of its powers of taxation.

67 Taking account of the foregoing, it must be held, first, that the difference in treatment to which the Kingdom of Spain subjects dividends paid to companies resident in another Member State, as compared with dividends paid to companies resident in Spain cannot be justified by the difference in the situation of those companies and, second, that the disadvantages arising from that difference in treatment of companies resident in other Member States is not neutralised by the conventions for the avoidance of double taxation concluded by the Kingdom of Spain.

68 Since the Kingdom of Spain has not put forward any overriding reason relating to the public interest justifying the restriction on the free movement of capital thus established, it must be held that the complaint relating to the infringement of Article 56(1) EC is well founded.

69 It is clear from all the foregoing that, by making the exemption of dividends distributed by companies resident in Spain subject to a level of holding by the recipient companies in the distributing companies which is higher for recipient companies residing in another Member State than for recipient companies resident in Spain, the Kingdom of Spain has failed to fulfil its obligations under Article 56(1) EC.

Infringement of Article 40 of the EEA Agreement

70 As a preliminary point, it must be recalled that the Court may of its own motion examine whether the conditions laid down in Article 226 EC for bringing an action for failure to fulfil obligations are satisfied (Case C-362/90 *Commission* v *Italy* [1992] ECR I-2353, paragraph 8; Case C-439/99 *Commission* v *Italy* [2002] ECR I-305, paragraph 8; Case C-98/04 *Commission* v *United Kingdom* [2006] ECR I-4003, paragraph 16; and Case C-195/04 *Commission* v *Finland* [2007] ECR I-3351, paragraph 21).

71 By virtue of Article 21 of the Statute of the Court of Justice and Article 38(1)(c) of the Rules of Procedure of the Court, the application must contain the subject-matter of the dispute and a brief statement of the pleas in law on which the application is based. Accordingly, in any application lodged under Article 226 EC, the Commission must indicate the specific complaints upon which the Court is called to rule and, at the very least in summary form, the legal and factual particulars on which those complaints are based (see, inter alia, Case C-390/07 *Commission* v *United Kingdom* [2009] ECR I-0000, paragraph 339).

72 In the present case, when it alleges infringement by the Kingdom of Spain of Article 40 of the EEA Agreement, the Commission merely refers to the difference in treatment arising from Article 14(1) of the Law on the tax on the income of non-residents as compared with the treatment of dividends paid to companies resident in Spain.

73 It must be held, as is clear from the very wording of Article 14(1) of the Law on the tax on the income of non-residents, that that provision applies only to dividends distributed to companies established in other Member States.

74 Since the Commission has failed to provide information relating to the legislation on dividends distributed to companies established in the EFTA States, the Court does not have sufficient evidence to enable it to determine precisely the scope of the infringement of Article 40 of the EEA Agreement allegedly committed by the Kingdom of Spain and thus to determine whether there is a breach of obligations as claimed by the Commission.

75 Accordingly, the complaint relating to the infringement of Article 40 of the EEA Agreement must be dismissed as inadmissible.

Costs

76 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs, if they have been applied for in the successful party's pleadings. Under Article 69(3) of the Rules of Procedure, the Court may, where each party succeeds on some and fails on other heads, or where the circumstances are exceptional, order that the costs be shared or that the parties bear their own costs. Since the Commission's application has been upheld only in part, each party must be ordered to bear its own costs.

On those grounds, the Court (First Chamber) hereby:

1. **Declares that, by making the exemption of dividends distributed by companies resident in Spain subject to a level of holding by the recipient companies in the distributing companies which is higher for recipient companies residing in another Member State than for recipient companies resident in Spain, the Kingdom of Spain has failed to fulfil its obligations under Article 56(1) EC.**

2. **Dismisses the action as to the remainder.**

3. **Orders the European Commission and the Kingdom of Spain to bear their own costs.**

[Signatures]

**Language of the case: Spanish.