JUDGMENT OF THE COURT (Second Chamber)

31 March 2011 (*)

(Free movement of capital – Direct taxation – Taxation of income from the letting of immovable property – Deductibility of annuities paid to a relative in the context of an anticipated succession inter vivos – Condition of being subject to unlimited tax liability in the Member State at issue)

In Case C-450/09,

REFERENCE for a preliminary ruling under Article 234 EC from the Niedersächsisches Finanzgericht (Germany), made by decision of 14 October 2009, received at the Court on 19 November 2009, in the proceedings

Ulrich Schröder

v

Finanzamt Hameln,

THE COURT (Second Chamber),

composed of J.N. Cunha Rodrigues, President of the Chamber, A. Arabadjiev, U. Lõhmus (Rapporteur), A. Ó Caoimh and P. Lindh, Judges,

Advocate General: Y. Bot,

Registrar: B. Fülöp, Administrator,

having regard to the written procedure and further to the hearing on 10 November 2010,

after considering the observations submitted on behalf of:

– Mr Schröder, by R. Geck, Rechtsanwalt,

– the Finanzamt Hameln, by P. Klose, acting as Agent,

– the German Government, by C. Blaschke, acting as Agent,

– the French Government, by G. de Bergues and J.-S. Pilczer, acting as Agents,

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

after hearing the Opinion of the Advocate General at the sitting on 9 December 2010,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 18 TFEU and 63 TFEU.

2 The reference has been made in proceedings between Mr Schröder and the Finanzamt Hameln (Tax Office Hameln, Germany) concerning the refusal by the Finanzamt Hameln to authorise the deduction of the annuity paid by Mr Schröder to his mother from the income derived from the letting of immovable property situated in Germany and acquired by him, inter alia, in the context of an anticipated succession *inter vivos*.

Legal context

European Union law

3 Article 1(1) of Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [article repealed by the Treaty of Amsterdam] (OJ 1988 L 178, p. 5) provides:

‘Without prejudice to the following provisions, Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States. To facilitate application of this Directive, capital movements shall be classified in accordance with the Nomenclature in Annex I.’

4 The capital movements listed in Annex I to Directive 88/361 include, in section XI of that annex, personal capital movements, which in turn include gifts and inheritances.

National law

5 Paragraph 1 of the Law on Income Tax (Einkommensteuergesetz), in the version applicable at the time of the facts in the main proceedings (BGBl. 2002 I, p. 4210; ‘the EStG’), provides, inter alia, that natural persons who have their domicile or habitual residence in Germany are subject to unlimited income tax liability, whereas those who are not domiciled or habitually resident in Germany are subject to limited income tax liability in the case where they receive income of German origin within the meaning of Paragraph 49 of the EStG. Income coming under Paragraph 49 includes that derived from the letting of immovable property situated in Germany.

6 Paragraph 10 of the EStG is entitled ‘Special expenditure’. Subparagraph 1 of that paragraph states as follows:

‘The following expenses shall constitute special expenditure where they are not business or occupational expenses:

…

1a. annuities and permanent burdens based on specific obligations, which have no economic link to income which is not taken into consideration in the assessment of tax; …’

7 Paragraph 50 of the EStG contains specific provisions concerning persons with limited tax liability. Under subparagraph 1:

‘Persons with limited tax liability may deduct business expenses (Paragraph 4(4) to (8)) or occupational expenses (Paragraph 9) only to the extent that those expenses are economically linked to income of German origin. ... Paragraphs ... 10 ... do not apply. ... ’

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

8 Mr Schröder is a German national who is resident and employed in Belgium.

9 By a document of 27 April 1992 certified by a notary, he acquired from his parents immovable property situated in Germany, which was subject to a right of usufruct in their favour. By a document of 2 December 2002 certified by a notary, other immovable property situated in Germany was transferred by their mother to Mr Schröder and his brother by means of anticipated succession *inter vivos*. The rights of usufruct which their mother had hitherto enjoyed over several properties were transformed into an annuity under the terms of which, from 1 December 2002, Mr Schröder and his brother each had to pay their mother a monthly sum of EUR 1 000.

10 For the year 2002, Mr Schröder received, in Germany, income of EUR 2 785 from the letting of the property acquired in 1992 and EUR 749.50 from the property held jointly by him and his brother.

11 The Finanzamt Hameln based the tax notice addressed to Mr Schröder in respect of the year 2002 on the sum of those two amounts and refused to take into account the annuity of EUR 1 000 paid by him in December 2002.

12 Mr Schröder brought an action against that refusal before the Niedersächsisches Finanzgericht (Finance Court of Lower Saxony). That court states that the possibility for a person such as Mr Schröder's brother, who resides in Germany and is, as a result, subject to unlimited income tax liability, to deduct from the taxable amount such an annuity as a category of special expenditure coming under Paragraph 10(1)(1a) of the EStG is well established in the case-law of the Bundesfinanzhof (Federal Finance Court). The Bundesfinanzhof, according to the Niedersächsisches Finanzgericht, takes the view that, in relation to immovable property transferred by means of anticipated succession *inter vivos*, the payments agreed, such as annuities, do not constitute consideration, or partial consideration, and it excludes those payments in full from the calculation of income.

13 However, according to the referring court, a person such as Mr Schröder, who, as a non-resident, is subject only to limited income tax liability in Germany, is not entitled to deduct such an annuity from his taxable income because Paragraph 50(1) of the EStG excludes the application of Paragraph 10 of the EStG to him.

14 The referring court has doubts as to whether this difference in the tax treatment of resident and non-resident taxpayers is compatible with European Union law and, in particular, with Article 63 TFEU.

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

'Is a situation where a relative with limited tax liability in the Federal Republic of Germany, unlike a person with unlimited tax liability, may not deduct from his total income, as special expenditure, annuities paid in connection with income from letting or leasing contrary to Articles [63 TFEU] and [18 TFEU]?'

Consideration of the question referred

Admissibility

16 The German Government takes the view that the reference for a preliminary ruling is inadmissible on the ground that the referring court fails to provide information concerning the factual circumstances and the legal context sufficient to enable the Member States, in particular, to comment on the present proceedings in full knowledge of the facts. First, there is no detailed information concerning the manner in which the immovable property was transferred to Mr

Schröder, the termination of the existing rights of usufruct and the payment of the monthly annuity. Second, there is insufficient information concerning the content and interpretation of the national legislation regarding special expenditure, within the meaning of Paragraph 10 of the EStG, and the differences between that expenditure and other categories of expenditure, such as business expenses and occupational expenses. In the absence of such detailed information, it is not possible to analyse the link between certain expenses of a non-resident taxpayer and his taxable income in order to determine whether such a taxpayer has been subject to unlawful discrimination.

17 In that regard, it should be recalled that the Court may reject a reference for a preliminary ruling submitted by a national court only where it is quite obvious that the interpretation of European Union law that is sought is unrelated to the actual facts of the main action or its purpose, where the problem is hypothetical, or where the Court does not have before it the factual or legal material necessary to give a useful answer to the questions submitted to it (see, inter alia, Case C-415/93 *Bosman* [1995] ECR I-4921, paragraph 61, and Case C-97/09 *Schmelz* [2010] ECR I-0000, paragraph 29).

18 With regard, more particularly, to the information that must be provided to the Court in an order for reference, that information does not serve only to enable the Court to provide answers which will be of use to the referring court; it must also enable the governments of the Member States, and other interested parties, to submit observations in accordance with Article 23 of the Statute of the Court of Justice. For those purposes, it is necessary that the national court should define the factual and legislative context of the questions which it is asking or, at the very least, explain the factual circumstances on which those questions are based (see, to that effect, Case C-345/06 *Heinrich* [2009] ECR I-1659, paragraphs 30 and 31, and Case C-42/07 *Liga Portuguesa de Futebol Profissional and Bwin International* [2009] ECR I-7633, paragraph 40).

19 However, in view of the division of responsibilities between the national courts and the Court of Justice on which the procedure referred to in Article 267 TFEU is based, the referring court cannot be required to make all the findings of fact and of law required by its judicial function before it may bring the matter before the Court. It is sufficient that both the subject-matter of the dispute in the main proceedings and the main issues raised for the European Union legal order may be understood from the reference for a preliminary ruling, in order to enable the Member States to submit their observations in accordance with Article 23 of the Statute of the Court of Justice and to participate effectively in the proceedings before the Court (*Liga Portuguesa de Futebol Profissional and Bwin International*, paragraph 41, and Case C-439/08 *VEBIC* [2010] ECR I-0000, paragraph 47).

20 In the present case, as is apparent from paragraphs 8 to 13 of the present judgment, the order for reference explains clearly, first, how the immovable property owned by Mr Schröder in Germany was acquired and the origin of the annuity which he is required to pay to his mother and, second, the effect of the national legislation at issue in the main proceedings with regard to the non-deductibility of that annuity from his taxable income. In addition, the referring court states that the resolution of the dispute which has been brought before it depends on its establishing whether the difference in treatment between a resident taxpayer and a non-resident taxpayer is compatible with European Union law.

21 Those elements are sufficient to explain the subject-matter of the dispute in the main proceedings and the main issues raised by it for the European Union legal order and to enable the Court to provide an answer which will be of use to the referring court. It should also be pointed out that the French Government and the European Commission have been able to submit to the Court detailed written observations on the question referred.

22 In the light of the foregoing, the reference for a preliminary ruling must be regarded as admissible.

Substance

23 By its question, the referring court asks, in essence, whether Articles 18 TFEU and 63 TFEU must be interpreted as precluding legislation of a Member State which, while allowing a resident taxpayer to deduct annuities paid to a relative who transferred to him immovable property situated in the territory of that State from the rental income generated by that property, does not allow such a deduction to be made by a non-resident taxpayer.

24 First, it is necessary to identify the provision of the FEU Treaty which is applicable to a situation such as that in the main proceedings.

25 With regard to Article 63 TFEU, it is settled case-law that, in the absence of a definition in the Treaty of 'movement of capital' within the meaning of Article 63(1) TFEU, the nomenclature which constitutes Annex I to Directive 88/361 retains an 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, which themselves became Articles 56 EC to 60 EC), it being understood that, according to the third paragraph of the introduction to that annex, the nomenclature which it contains is not exhaustive as regards the notion of movements of capital (see, inter alia, Case C-318/07 *Persche* [2009] ECR I-359, paragraph 24 and the case-law cited; Case C-182/08 *Glaxo Wellcome* [2009] ECR I-8591, paragraph 39; Case C-35/08 *Busley and Cibrian Fernandez* [2009] ECR I-9807, paragraph 17; and Case C-25/10 *Missionswerk Werner Heukelbach* [2011] ECR I-0000, paragraph 15).

26 In that regard, the Court has already held that inheritances and gifts, which fall under section XI of Annex I to Directive 88/361, entitled 'Personal Capital Movements', constitute movements of capital within the meaning of Article 63 TFEU, except in cases where their constituent elements are confined within a single Member State (see, to that effect, *Persche*, paragraph 27; *Busley and Cibrian Fernandez*, paragraph 18; and *Missionswerk Werner Heukelbach*, paragraph 16).

27 Consequently, it must be held that the transfer of immovable property situated in Germany, as a gift or by means of anticipated succession *inter vivos*, to a natural person resident in Belgium comes within the scope of Article 63 TFEU.

28 As regards Article 18 TFEU, which lays down a general prohibition of all discrimination on grounds of nationality, it should be noted that that provision applies independently only to situations governed by European Union law for which the Treaty does not lay down any specific rules of non-discrimination (see, inter alia, Case C-443/06 *Hollmann* [2007] ECR I-8491, paragraph 28 and the case-law cited; Case C-311/08 *SGI* [2010] ECR I-0000, paragraph 31; and *Missionswerk Werner Heukelbach*, paragraph 18).

29 Since the Treaty provisions on the free movement of capital are applicable and provide specific rules on non-discrimination, Article 18 TFEU is not applicable to the main proceedings (see *Hollmann*, paragraph 29, and *Missionswerk Werner Heukelbach*, paragraph 19).

30 Second, it should be noted that the measures prohibited by Article 63(1) TFEU, as restrictions on the movement of capital, include those which are liable to discourage non-residents from making investments in a Member State or from maintaining such investments (see, to that effect, Case C-377/07 *STEKO Industriemontage* [2009] ECR I-299, paragraphs 23 and 24 and the case-law cited).

31 With regard to the legislation at issue in the main proceedings, a natural person who is not domiciled or habitually resident in Germany is, according to Paragraph 49 of the EStG, liable to income tax in that Member State in respect of income derived from the letting of immovable property situated in Germany. In contrast to resident taxpayers, a non-resident taxpayer may not, under Paragraph 50 of the EStG, deduct from that income an annuity, such as that paid by Mr Schröder to his mother in the context of the anticipated succession *inter vivos*, as special expenditure within the meaning of Paragraph 10(1)(1a) of the EStG.

32 Less favourable tax treatment reserved for non-residents alone might deter them from acquiring or retaining immovable property situated in Germany (see, by analogy, Case C-512/03 *Blanckaert* [2005] ECR I-7685, paragraph 39). It might also deter German residents from naming, as beneficiaries of an anticipated succession *inter vivos*, persons resident in a Member State other than the Federal Republic of Germany (see, by analogy, *Missionswerk Werner Heukelbach*, paragraph 25).

33 Such legislation constitutes, therefore, a restriction on the free movement of capital which is prohibited, in principle, by Article 63 TFEU.

34 It is true that, according to Article 65(1)(a) TFEU, Article 63 TFEU is without prejudice to the right of Member States to distinguish, in their tax law, between taxpayers who are not in the same situation with regard to their place of residence.

35 However, it is important to distinguish unequal treatment permitted under Article 65(1)(a) TFEU from arbitrary discrimination or disguised restrictions prohibited under Article 65(3) TFEU. In order for national tax legislation such as that at issue in the main proceedings, which distinguishes between resident and non-resident taxpayers, to be regarded as compatible with the Treaty provisions on the free movement of capital, the difference in treatment must relate to situations which are not objectively comparable or must be justified by an overriding reason in the public interest. Moreover, in order to be justified, the difference in treatment must not go beyond what is necessary in order to attain the objective of the legislation in question (see *Persche*, paragraph 41, and Case C-510/08 *Mattner* [2010] ECR I-0000, paragraph 34).

36 It is thus necessary to examine whether, in the circumstances of the dispute in the main proceedings, the situation of non-residents is comparable to that of residents.

37 In that regard, it is settled case-law that, in relation to direct taxes, the situations of residents and non-residents within a State are not, as a rule, comparable, since the income received in the territory of a Member State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence, and because a non-resident's personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is easier to assess at the place where his personal and financial interests are centred, which in general is the place where he is habitually resident (Case C-279/93 *Schumacker* [1995] ECR I-225, paragraphs 31 and 32; Case C-234/01 *Gerritse* [2003] ECR I-5933, paragraph 43; and Case C-562/07 *Commission* v *Spain* [2009] ECR I-9553, paragraph 46).

38 Furthermore, the fact that a Member State does not grant to a non-resident certain tax benefits which it grants to a resident is not, as a rule, discriminatory, having regard to the objective differences between the situation of residents and that of non-residents, from the point of view both of the source of their income and of their personal ability to pay tax or their personal and family circumstances (*Schumacker*, paragraph 34; *Gerritse*, paragraph 44; and *Commission* v *Spain*, paragraph 47).

39 In the present case, it is not in dispute that the rental income generated in the course of 2002 by the immovable property owned by Mr Schröder in Germany constituted only a small part of the overall income received by him during that year.

40 However, the Court has held, in relation to expenses, such as business expenses which are directly linked to an activity which has generated taxable income in a Member State, that residents and non-residents of that State are in a comparable situation, with the result that legislation of that State which denies non-residents, in matters of taxation, the right to deduct such expenses, while, on the other hand, allowing residents to do so, risks operating mainly to the detriment of nationals of other Member States and therefore constitutes indirect discrimination on grounds of nationality (see *Gerritse*, paragraphs 27 and 28; Case C-346/04 *Conijn* [2006] ECR I-6137, paragraph 20; Case C-290/04 *FKP Scorpio Konzertproduktionen* [2006] ECR I-9461, paragraph 49; Case C-345/04 *Centro Equestre da Lezíria Grande* [2007] ECR I-1425, paragraph 23; Case C-11/07 *Eckelkamp and Others* [2008] ECR I-6845, paragraph 50; and Case C-43/07 *Arens-Sikken* [2008] ECR I-6887, paragraph 44).

41 It follows that legislation such as that at issue in the main proceedings would in principle be contrary to Article 63 TFEU if the annuity paid by Mr Schröder to his mother were to be regarded as expenditure directly linked to the activity of Mr Schröder in letting the immovable property situated in Germany which was transferred to him by his parents.

42 The German Government takes the view that there is no direct link in the present case. According to it, such an annuity, classified as special expenditure coming under Paragraph 10(1)(1a) of the EStG, differs from business expenses and occupational expenses which, under Paragraph 50(1) of the EStG, can be deducted by a taxpayer with limited tax liability in so far as they represent the consideration for the acquisition of a source of income. The payment of such an annuity, it argues, is not the normal or legal consequence of the receipt of rental income but forms part of a family support arrangement, with the amount being fixed not by reference to the value of the assets transferred but according to the personal needs of the recipient and the debtor’s general economic ability to pay, matters which can be adequately assessed only by the Member State in which the debtor is resident. Also in that context, the French Government observes that the amount of the annuity is affected neither by the lack of rental income nor, conversely, by the receipt of very substantial income.

43 Those arguments cannot be accepted. Even assuming that the amount of an annuity, such as that paid by Mr Schröder, is determined on the basis of the ability of the debtor to pay and the recipient’s personal needs, the fact remains that the existence of a direct link within the meaning of the case-law cited in paragraph 40 of the present judgment results, not from a correlation, of whatever kind, between the amount of the expenditure in question and that of the taxable income, but from the fact that that expenditure is inextricably linked to the activity which gives rise to that income (see, in that regard, *Centro Equestre da Lezíria Grande*, paragraph 25).

44 Thus, the Court has taken the view that expenses occasioned by the activity in question are directly linked to that activity (see, to that effect, *Gerritse*, paragraphs 9 and 27, and *Centro Equestre da Lezíria Grande*, paragraph 25) and are, thus, necessary in order to carry out that activity. Likewise, such a direct link was accepted with regard to costs incurred in obtaining tax advice required in order to prepare a tax return, the duty to file such a return resulting from the receipt of income in the Member State concerned (see *Conijn*, paragraph 22).

45 According to the order for reference, the immovable property transferred to Mr Schröder was, at least in part, subject to rights of usufruct which were converted into a monthly annuity which he is required to pay to his mother. It therefore appears that the undertaking to pay that annuity results

from the transfer of that property, that undertaking having been necessary to enable Mr Schröder to assume ownership of the property and, consequently, generate the rental income at issue in the main proceedings which is subject to tax in Germany.

46 The view must therefore be taken that, to the extent that Mr Schröder's undertaking to pay the annuity to his mother results from the transfer to him of immovable property situated in Germany – that being a matter for the referring court to establish – that annuity constitutes an expense directly linked to the use of that property, with the result that Mr Schröder is in that regard in a situation comparable to that of a resident taxpayer.

47 In those circumstances, national provisions which, in matters of income tax, deny non-residents the right to deduct such an expense, while that right is, by contrast, granted to residents, is, in the absence of valid justification, contrary to Article 63 TFEU.

48 No overriding reason in the public interest has been invoked by the German Government or contemplated by the referring court.

49 In view of the foregoing, the answer to the question referred is that Article 63 TFEU must be interpreted as precluding legislation of a Member State which, while allowing a resident taxpayer to deduct the annuities paid to a relative who transferred to him immovable property situated in the territory of that State from the rental income derived from that property, does not grant such a deduction to a non-resident taxpayer, in so far as the undertaking to pay those annuities results from the transfer of that property.

Costs

50 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 (Second Chamber) hereby rules:

Article 63 TFEU must be interpreted as precluding legislation of a Member State which, while allowing a resident taxpayer to deduct the annuities paid to a relative who transferred to him immovable property situated in the territory of that State from the rental income derived from that property, does not grant such a deduction to a non-resident taxpayer, in so far as the undertaking to pay those annuities results from the transfer of that property.

[Signatures]

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* Language of the case: German.