61997J0307

Judgment of the Court of 21 September 1999. - Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt. - Reference for a preliminary ruling: Finanzgericht Köln - Germany. - Freedom of establishment - Taxes on companies' income - Tax concessions. - Case C-307/97.

European Court reports 1999 Page I-06161

Keywords

Freedom of movement for persons - Freedom of establishment - Tax legislation - Corporation tax - Capital tax - Where a Member State refuses to grant to permanent establishments of non-resident companies certain tax concessions reserved for resident companies - Not permissible - Whether justifiable - No justification

(EC Treaty, Arts 52 (now, after amendment, Art. 43 EC) and 58 (now Art. 48 EC))

Summary

$$Article 52 of the Treaty (now, after amendment, Article 43 EC) and Article 58 thereof (now Article 48 EC) preclude the exclusion of a permanent establishment in Germany of a company limited by shares having its seat in another Member State from enjoyment, on the same conditions as those applicable to companies limited by shares having their seat in Germany, of tax concessions taking the form of:

- an exemption from corporation tax for dividends received from companies established in non-member countries (corporation tax relief for international groups), provided for by a treaty for the avoidance of double taxation concluded with a non-member country,

- the crediting, against German corporation tax, of the corporation tax levied in a State other than the Federal Republic of Germany on the profits of a subsidiary established there, provided for by German legislation, and

- an exemption from capital tax for shareholdings in companies established in non-member countries (capital tax relief for international groups), also provided for by German legislation.

The refusal to grant those tax concessions - which primarily affects non-resident companies and is based on the criterion of the company's corporate seat in determining the applicable tax rules - makes it less attractive for such companies to have intercorporate holdings through branches in the Member State concerned, which thus restricts the freedom to choose the most appropriate legal form for the pursuit of activities in another Member State, which the second sentence of the first paragraph of Article 52 of the Treaty expressly confers on economic operators. In view of the fact that, as regards liability to tax on dividend receipts in Germany from shares in foreign subsidiaries and sub-subsidiaries and on the holding of those shares, companies not resident in Germany having a permanent establishment there and companies resident in Germany are in objectively comparable situations, the difference in treatment to which branches of non-resident companies are subject in comparison with resident companies must be regarded as constituting an infringement of Articles 52 and 58 of the Treaty.

As regards, specifically, the refusal to grant to permanent establishments of non-resident companies the international group relief provided for by a bilateral agreement, concluded in order to prevent double taxation, finds no justification in the fact that the Member States are at liberty, in the framework of such agreements, to determine the connecting factors for the purposes of allocating powers of taxation as between themselves. As far as the exercise of the power of taxation so allocated is concerned, the Member States nevertheless may not disregard Community rules, under which the national treatment principle requires a Member State which is party to the agreement to grant to permanent establishments of non-resident companies the advantages provided for thereunder on the same conditions as those which apply to resident companies.

Parties

In Case C-307/97,

REFERENCE to the Court under Article 177 of the EC Treaty (now Article 234 EC) by the Finanzgericht Köln, Germany, for a preliminary ruling in the proceedings pending before that court between

Compagnie de Saint-Gobain, Zweigniederlassung Deutschland

and

Finanzamt Aachen-Innenstadt

on the interpretation of Article 52 of the EC Treaty (now, after amendment, Article 43 EC) and Article 58 of the EC Treaty (now Article 48 EC),

THE COURT,

composed of: G.C. Rodríguez Iglesias, President, P.J.G. Kapteyn and G. Hirsch (Presidents of Chambers), J.C. Moitinho de Almeida, C. Gulmann, J.L. Murray, D.A.O. Edward, H. Ragnemalm, L. Sevón, M. Wathelet (Rapporteur) and R. Schintgen, Judges,

Advocate General: J. Mischo,

Registrar: L. Hewlett, Administrator,

after considering the written observations submitted on behalf of:

- Compagnie de Saint-Gobain, Zweigniederlassung Deutschland, by A.J. Rädler, Tax Adviser, Munich, and M. Lausterer, Rechtsanwalt, Munich,

- the Finanzamt Aachen-Innenstadt, by A. Jansen, Leitender Regierungsdirektor of the Finanzamt Aachen-Innenstadt,

- the German Government, by E. Röder, Ministerialrat at the Federal Ministry of Economic Affairs, and C.-D. Quassowski, Regierungsdirektor at the same Ministry, acting as Agents,

- the Portuguese Government, by L. Fernandes, Director of the Legal Service of the Directorate-General for the European Communities of the Ministry of Foreign Affairs, and A. Cortesão Seiça Nevex, a lawyer in the same Service, acting as Agents,

- the Swedish Government, by Eric Brattgård, Departmentsråd in the Department of Foreign Trade of the Ministry of Foreign Affairs, acting as Agent,

- the Commission of the European Communities, by H. Michard, of its Legal Service, and A. Buschmann, a German civil servant on secondment to the Commission's Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Compagnie de Saint-Gobain, Zweigniederlassung Deutschland, represented by A.J. Rädler and M. Lausterer; of the Finanzamt Aachen-Innenstadt, represented by P. Martin, Leitender Regierungsdirektor of the Finanzamt Aachen-Innenstadt; of the German Government, represented by C.-D. Quassowski, Regierungsdirektor at the Federal Ministry of Economic Affairs, acting as Agent; and of the Commission, represented by E. Mennens, Principal Legal Adviser, acting as Agent, and by H. Michard and A. Buschmann, at the hearing on 19 January 1999,

after hearing the Opinion of the Advocate General at the sitting on 2 March 1999,

gives the following

Judgment

In Case C-307/97,

REFERENCE to the Court under Article 177 of the EC Treaty (now Article 234 EC) by the Finanzgericht Köln, Germany, for a preliminary ruling in the proceedings pending before that court between

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THE COURT,

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after considering the written observations submitted on behalf of:

- Compagnie de Saint-Gobain, Zweigniederlassung Deutschland, by A.J. Rädler, Tax Adviser, Munich, and M. Lausterer, Rechtsanwalt, Munich,

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- the Portuguese Government, by L. Fernandes, Director of the Legal Service of the Directorate-General for the European Communities of the Ministry of Foreign Affairs, and A. Cortesão Seiça Nevex, a lawyer in the same Service, acting as Agents,

- the Swedish Government, by Eric Brattgård, Departmentsråd in the Department of Foreign Trade of the Ministry of Foreign Affairs, acting as Agent,

- the Commission of the European Communities, by H. Michard, of its Legal Service, and A. Buschmann, a German civil servant on secondment to the Commission's Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Compagnie de Saint-Gobain, Zweigniederlassung Deutschland, represented by A.J. Rädler and M. Lausterer; of the Finanzamt Aachen-Innenstadt, represented by P. Martin, Leitender Regierungsdirektor of the Finanzamt Aachen-Innenstadt; of the German Government, represented by C.-D. Quassowski, Regierungsdirektor at the Federal Ministry of Economic Affairs, acting as Agent; and of the Commission, represented by E. Mennens, Principal Legal Adviser, acting as Agent, and by H. Michard and A. Buschmann, at the hearing on 19 January 1999,

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gives the following

Judgment

Grounds

1 By order of 30 June 1997, received at the Court on 2 September 1997, the Finanzgericht Köln (Finance Court, Cologne) referred to the Court for a preliminary ruling under Article 177 of the EC Treaty (now Article 234 EC) three questions on the interpretation of Article 52 of the EC Treaty (now, after amendment, Article 43 EC) and Article 58 of the EC Treaty (now Article 48 EC).

2 The three questions have been raised in proceedings between Compagnie de Saint-Gobain, Zweigniederlassung Deutschland (hereinafter `Saint-Gobain ZN'), and the Finanzamt (Tax Office) Aachen-Innenstadt (hereinafter `the Finanzamt').

3 Saint-Gobain ZN is the German branch of Compagnie de Saint-Gobain SA (hereinafter `Saint-Gobain SA'), which is a company incorporated under French law whose seat and business management are located in France.

4 For the purposes of German tax law, Saint-Gobain ZN, which is entered in the commercial register in Germany, is treated as a permanent establishment of Saint-Gobain SA.

5 In Germany, Saint-Gobain SA is subject to limited tax liability because neither its seat nor its business management are located in that State. This limited tax liability of Saint-Gobain SA relates to both the income earned in Germany through its permanent establishment, under Paragraph 2(1) of the Körperschaftsteuergesetz (Law on Corporation Tax, hereinafter `the KStG'), and the assets held in its permanent establishment, under Paragraph 2(1)(2) and 2(2) of the Vermögensteuergesetz (Law on Capital Tax, hereinafter `the VStG').

6 Under the combined provisions of Paragraph 8(1) of the KStG and Paragraph 49(1)(2)(a) of the Einkommensteuergesetz (Law on Income Tax, hereinafter `the EStG'), income from an industrial and commercial establishment located within German territory forms part of domestic income, within the meaning of limited tax liability.

7 Furthermore, under Paragraph 121(2)(3), of the Bewertungsgesetz (Law on the Evaluation of Assets, hereinafter `the BewG'), domestic operating capital forms part of the domestic assets of a taxpayer subject to limited tax liability, which includes in particular the capital used in the establishment which the taxpayer exploits within German territory.

8 The Finanzamt refused to grant Saint-Gobain SA certain tax concessions relating to the taxation of dividends from shares in foreign companies limited by shares, those concessions being restricted to companies subject in Germany to unlimited tax liability.

9 In 1988, the relevant year in the main proceedings, Saint-Gobain SA held, through the operating capital of its German branch, Saint-Gobain ZN, the following shareholdings:

- 10.2% of the shares of the company Certain Teed Corporation, established in the United States of America;

- 98.63% of the share capital of the company Grünzweig & Hartmann AG (hereinafter `Grünzweig'), established in Germany;

- 99% of the share capital of the company Gevetex Textilglas GmbH (hereinafter `Gevetex'), established in Germany.

10 The subsidiaries of Saint-Gobain SA which are established in Germany, namely Grünzweig and Gevetex, are bound to Saint-Gobain ZN by an agreement on treatment as a single entity for tax purposes (`Organvertrag') under Paragraph 18 of the KStG. In the case of a group treated as a single entity for German tax purposes (`Organschaft'), the parent company (the dominant company or `Organträger') of a group of companies declares that it is solely liable for the tax on the group's aggregate out-turn. The profits and losses of the minor companies (`Organgesellschaften') are *incorporated in the profits and losses of the dominant company and, where appropriate, subject to the tax for which the latter company is liable, on condition that the minor German companies are financially, economically and organisationally integrated into a German undertaking - or, on certain conditions, into the permanent establishment in Germany of a foreign company, as is the case with the Saint-Gobain group - and that there is a profit-transfer agreement between the minor companies and the dominant company (`Gewinnabführungsvertrag') lasting at least five years (Paragraph 14 of the KStG).*

11 The profits of Grünzweig and Gevetex, which were transferred to Saint-Gobain ZN during 1988 under such profit-transfer agreements, included group dividends distributed by foreign subsidiaries.

12 In 1988, Grünzweig received dividends from the companies Isover SA, established in Switzerland, and Linzer Glasspinnerei Franz Haider AG, established in Austria, in which it held, in 1988, 33.34% and 46.67% respectively of their shares.

13 In that same year, Gevetex received dividends from an Italian subsidiary, the company Vitrofil SpA, in which it had a 24.8% shareholding.

14 It appears from the national court's file that the other conditions relating to tax integration were fulfilled, so that those dividends were, in accordance with German tax law, directly attributed to the permanent establishment situated within German territory (Saint-Gobain ZN) and therefore to the income of the dominant company (Saint-Gobain SA) subject to limited tax liability (Paragraphs 14 and 18 of the KStG).

15 Saint-Gobain ZN is challenging before the Finanzgericht the refusal of the Finanzamt to grant it three tax concessions designed to prevent dividends which are received in Germany by companies with shareholdings in foreign companies and which have already been taxed abroad from being taxed again in Germany.

16 First, the Finanzamt refused to grant an exemption from German corporation tax for the dividends received by Saint-Gobain ZN from the United States of America and Switzerland on the ground that the treaties for the avoidance of double taxation concluded between the Federal Republic of Germany and each of those two non-member countries, which provide for such exemption, restrict it to, respectively, German companies and companies subject in Germany to unlimited tax liability. The concession concerned is a form of international group relief from corporation tax in respect of profits distributed between parent company and subsidiary (`internationales Schachtelprivileg').

17 Article XV of the old convention concluded between the Federal Republic of Germany and the United States of America for the avoidance of double taxation with respect to taxes on income and to certain other taxes, of 22 July 1954, as amended by the Protocol of 17 September 1965 (BGBl. 1954 II, p. 1118; 1966 II, p. 745), in force at the relevant time, provides:

`(1) It is agreed that double taxation shall be avoided in the following manner:

(a) ...

(b) 1. Federal Republic tax shall be determined in the case of a natural person resident in the Federal Republic or of a German company as follows:

(aa) ... there shall be excluded from the basis upon which Federal Republic tax is imposed any item of income from sources within the United States or any item of capital situated within the United States which, according to this Convention, is not exempt from tax by the United States. ... The first sentence shall, in the case of income from dividends, apply only to such dividends subject

to tax under United States law as are paid to a German company limited by shares (Kapitalgesellschaft) by a United States corporation, at least 25 percent of the voting shares of which are owned directly by the first-mentioned company ...'.

According to Article II(1)(f) of the same Convention, `German company' means a juridical person having its business management or seat in Germany.

18 Article 24 of the Convention concluded on 11 August 1971 between the Federal Republic of Germany and the Swiss Confederation for the avoidance of double taxation with respect to taxes on income and capital, as amended by the Protocol of 30 November 1978 (BGBl. 1972 II, p. 1022; 1980 II, p. 750), provides, in the version which was in force in relation to taxes collected before 1990:

`(1) As regards a person established in the Federal Republic of Germany, double taxation shall be avoided in the following manner:

(1) The following income, originating in Switzerland, which, according to the preceding articles, is taxable in Switzerland, shall be excluded from the basis on which German tax is imposed:

(a) ...

(b) The dividends, within the meaning of Article 10, which a company limited by shares established in Switzerland distributes to a company limited by shares subject to unlimited tax liability in the Federal Republic of Germany where, according to German tax legislation, a Swiss tax levied on the profits of the distributing company could also be credited against German corporation tax to be levied on the German company.'

19 Second, although the Finanzamt allowed Saint-Gobain SA the direct credit provided for in Paragraph 26(1) of the KStG and therefore credited against the German corporation tax payable by Saint-Gobain SA on dividends received through Saint-Gobain ZN the foreign tax which it had already paid and which had been withheld at source in the various countries in which the distributing companies are established, it refused a credit for the foreign corporation tax levied on the profits distributed by the foreign subsidiaries and sub-subsidiaries of Saint-Gobain SA in the countries in which they are established (indirect credit, also called `indirect tax credit', which is provided for in Paragraph 26(2) of the KStG) because the law restricts that concession to companies subject in Germany to unlimited tax liability.

20 Paragraph 26(2) of the KStG lays down the rules on indirect credit:

`(2) If, for at least 12 months before the balance-sheet date ... a company ... (parent company) having unlimited tax liability ... has held directly and uninterruptedly a share of at least one tenth in the nominal share capital of a company limited by shares having its management and its seat outside the territorial scope of this Law (subsidiary company) ... the parent company may, upon application, also be allowed to credit against the corporation tax for which it is liable in respect of dividends distributed to it by the subsidiary a tax on the profits of the latter company. The credit shall relate to a fraction of the tax analogous to the German corporation tax which the subsidiary paid in respect of the financial year for which it made the distribution'.

21 Third, the Finanzamt included the shareholding in the American subsidiary in the domestic assets of the permanent establishment, taxable by way of capital tax, and did not therefore allow Saint-Gobain SA the capital tax concession for international groups provided for by Paragraph 102(2) of the BewG since that Law restricts that concession to domestic companies limited by shares.

22 Paragraph 102(2) of the BewG provides:

`(2) If a German company limited by shares ... has a direct holding in the nominal share capital of a company limited by shares having its seat and business management outside the scope of this Law (subsidiary company) and that holding is at least 10%, that holding shall, upon application, be excluded from the company's business assets, provided that the shareholding has existed uninterruptedly for at least 12 months before the relevant balance-sheet date ...'.

23 Saint-Gobain SA considers that it is contrary to the combined provisions of Articles 52 and 58 of the Treaty for the German permanent establishment of a company limited by shares established in France to be excluded from the benefit of the tax concessions described above (indirect credit and corporation-tax relief and capital-tax relief for international groups).

24 The Finanzgericht Köln found that, under applicable German law as it stood in 1988, those concessions could be denied to a German permanent establishment of a foreign company limited by shares. However, it considered that having regard in particular to the judgment in Case 270/83 Commission v France [1986] ECR 273, paragraph 18, a refusal to allow the concessions could constitute discrimination contrary to Article 52 of the Treaty.

25 It should be explained that the domestic legal context was changed, with effect from the 1994 tax period, by the Standortsicherungsgesetz (Law to Maintain and Improve the Attraction of the Federal Republic as a Site for Business) of 13 September 1993, BGBl. I, p. 1569), which introduced Paragraph 8b(4) and Paragraph 26(7) into the KStG.

26 Paragraph 8b(4) of the KStG (shareholdings in foreign companies) provides:

`(4) Shares of profits which are distributed by a foreign company in respect of shares which are to be attributed to a German permanent business establishment of a company subject to limited tax liability shall not be taken into account in the calculation of the income to be attributed to the German permanent business establishment if, under a treaty for the avoidance of double taxation ..., they would be exempt if the company subject to limited tax liability were subject to unlimited tax liability. ... If the exemption or the concession depends on the holding of the share for a minimum period, the shareholding during that period must also have belonged to the operating assets of the German permanent business establishment'.

27 Paragraph 26(7) of the KStG, in the version in force as from the 1994 tax period, which extends the indirect credit provided for in Paragraph 26(2) of the KStG to German branch establishments, provides:

`Subparagraphs (2) and (3) shall be applicable by analogy to shares of profits which a German branch establishment of a company subject to limited tax liability receives from a foreign subsidiary if the conditions laid down in the first and third sentences of Paragraph 8b(4) are fulfilled.'

28 According to the information provided by the Finanzgericht, the legislature explained the reason for the amendment thus:

`The German branch establishment of a company subject to limited tax liability is thus assimilated to a German company. The equal treatment between the permanent establishment of a foreign company and a company subject to unlimited tax liability takes into account the freedom of establishment provided for in Article 52 of the EEC Treaty and excludes discrimination prohibited by those provisions' (Bundesrats Drucksache 1/93, pp. 40 and 41).

29 However, the changes made to the national legislation did not take effect until after the 1994 tax period (Paragraph 54(1) of the KStG, in the version applicable under the Law of 13 September 1993) and cannot therefore be taken into account in the main proceedings.

30 It should also be pointed out that the Standortsicherungsgesetz of 13 September 1993 has not amended Paragraph 102 of the BewG on intercorporate capital tax relief. However, according to the Commission, which was not contradicted on this point at the hearing, capital tax has not been levied since 1 January 1997 on the ground that it is in part unconstitutional, as found by the Bundesverfassungsgericht (Federal Constitutional Court) in its judgment of 22 June 1995 (2 BvL 37/91 BVerfGE 93, 121). Paragraph 102 of the BewG was repealed by Paragraph 6(14) and 6(15) of the Gesetz zur Fortsetzung der Unternehmenssteuerreform (Law on the Furtherance of Corporation Tax Reform) of 29 October 1997 (BGBl. I, p. 2590).

31 In those circumstances, the Finanzgericht Köln decided to stay proceedings and to refer the following questions to the Court for a preliminary ruling:

`(1) Is it compatible with the applicable Community law, and in particular with Articles 52 and 58 of the EC Treaty, read together, for a branch establishment in Germany of a company having its seat in another Member State not to be accorded Schachtelprivileg [a form of tax relief in respect of profits distributed between parent company and subsidiary] in respect of dividends under a double-taxation agreement with a non-member State under the same conditions as for a company having its seat in Germany?

(2) Is it compatible with the applicable Community law, and in particular with Articles 52 and 58 of the EC Treaty, read together, for the tax levied in a non-member State on the profits of a subsidiary in that State of a branch establishment in Germany of a company having its seat in another Member State not to be credited against the German corporation tax on that German branch establishment under the same conditions as for a company having its seat in Germany?

(3) Is it compatible with the applicable Community law, and in particular with Articles 52 and 58 of the EC Treaty, read together, for a branch establishment in Germany of a company having its seat in another Member State not to be accorded Schachtelprivileg in respect of capital tax under the same conditions as for a company having its seat in Germany?'

32 By its three questions, which it is appropriate to examine together, the Finanzgericht is asking essentially whether Articles 52 and 58 of the Treaty preclude the exclusion of a permanent establishment in Germany of a company limited by shares having its seat in another Member State (hereinafter `the non-resident company') from enjoyment, on the same conditions as those applicable to companies limited by shares having their seat in Germany, of tax concessions taking the form of:

- an exemption from corporation tax for dividends received from companies established in non-member countries (corporation tax relief for international groups), provided for by a treaty for the avoidance of double taxation concluded with a non-member country,

- the crediting, against German corporation tax, of the corporation tax levied in a State other than the Federal Republic of Germany on the profits of a subsidiary established there, provided for by German legislation, and

- an exemption from capital tax for shareholdings in companies established in non-member countries (capital tax relief for international groups), also provided for by German legislation.

33 According to settled case-law, Article 52 of the Treaty constitutes a fundamental provision which has been directly applicable in the Member States since the end of the transitional period *(see, in particular, the judgments in Case 71/76 Thieffry [1977] ECR 765, Commission v France, cited above, paragraph 13, and Case C-311/97 Royal Bank of Scotland [1999] ECR I-2651, paragraph 22).*

34 The freedom of establishment conferred by Article 52 of the Treaty on nationals of Member States of the Community, which entails for them access to, and pursuit of, activities as employed persons and the forming and management of undertakings on the same conditions as those laid down for its own nationals by the laws of the Member State where establishment is effected, includes, pursuant to Article 58 of the Treaty, the right of companies or firms formed in accordance with the laws of a Member State and having their registered office, central administration or principal place of business within the Community to pursue their activities in the Member State concerned through a branch or an agency (see Case C-264/96 ICI [1998] ECR I-4695, paragraph 20, and the case-law cited there). Those two provisions guarantee nationals of Member States of the Community who have exercised their freedom of establishment and companies or firms which are assimilated to them the same treatment in the host Member State as that accorded to nationals of that Member State.

35 As far as companies or firms are concerned, their corporate seat, in the sense expressed above, serves to determine, like nationality for natural persons, their connection to a Member State's legal order (see ICI, cited above, paragraph 20, and the case-law cited there).

36 The practice in question in the main proceedings consists in refusing to grant to a non-resident company limited by shares, which operates a branch in Germany through which it holds shares in companies established in States other than the Federal Republic of Germany and through which it receives dividends on such shares, certain concessions in relation to the taxation of those shareholdings or those dividends which are restricted to companies subject in Germany to unlimited tax liability, either under domestic tax legislation or under bilateral treaties for the avoidance of double taxation concluded with non-member countries.

37 It should be explained here that companies subject to unlimited tax liability in Germany are, under German law, companies considered to be resident in Germany for tax purposes, that is to say companies which have their registered office or business management in Germany (Paragraph 1 of the KStG). The refusal to grant the tax concessions in question therefore affects in principle companies not resident in Germany and is based on the criterion of the company's corporate seat in determining the tax rules applying in Germany to shareholdings in companies limited by shares established in States other than the Federal Republic of Germany and to dividends from such shareholdings.

38 It is not contested that, for those companies to which they are granted, the tax concessions represented by corporation tax relief for international groups and by indirect credit result in a lighter tax burden, so that the permanent establishments of companies having their corporate seat in another Member State (`non-resident companies') which cannot qualify for them are in a less favourable situation than resident companies, including German subsidiaries of non-resident companies.

39 However, as far as capital tax is concerned, the German Government argues that the situation of the permanent establishment of a non-resident company not allowed the concession for international groups is not less favourable than that of the resident subsidiary of a non-resident company which does receive this tax concession since the tax burden on the non-resident company (parent or dominant company) is the same irrespective of whether shareholdings are held through a permanent establishment or through a subsidiary. For capital tax purposes, a shareholding in a foreign sub-subsidiary is included in the assets of the permanent establishment and is therefore taxed as an asset of the dominant company. Secondly, if the shareholding in a foreign sub-subsidiary is excluded from the subsidiary's assets by the international group concession, the assets of the non-resident parent company will include the value of its *shareholding in the subsidiary held in Germany, evaluated with account taken of the value of the shares which it holds itself in the sub-subsidiary, pursuant to Paragraph 121(2)(4) of the BewG, in force at the relevant time. The German subsidiary's shareholding in a foreign sub-subsidiary is therefore also taxed as an asset of the parent company not resident in Germany.*

40 However, at the hearing Saint-Gobain ZN explained, without being contradicted on this point, that the application of Paragraph 121(2)(4) of the BewG had been set aside in its case by virtue of Article 19 of the treaty for the avoidance of double taxation concluded between the Federal Republic of Germany and the French Republic on 21 July 1959 (JORF of 8 November 1961, p. 10230, amended on 9 June 1969, JORF of 22 November 1970, p. 10725), the effect of which is to exclude taxation, as an asset of the parent company not resident in Germany, of the shareholding held by a German subsidiary in a foreign sub-subsidiary. According to Saint-Gobain ZN, the German rules governing the grant of capital tax exemption for international groups therefore produce a tax burden on a permanent establishment of a foreign company which is different from that on a subsidiary of a foreign company.

41 As far as this point is concerned, it is for the Finanzgericht to determine, in the case before it, whether the refusal to grant capital tax exemption for international groups to the permanent establishments of French companies puts them in a situation less favourable than that of German subsidiaries of French companies.

42 In those circumstances, the refusal to grant the tax concessions in question to the permanent establishments in Germany of non-resident companies makes it less attractive for those companies to have intercorporate holdings through German branches, since under German law and double-taxation treaties the tax concessions in question can only be granted to German subsidiaries which, as legal persons, are subject to unlimited tax liability, which thus restricts the freedom to choose the most appropriate legal form for the pursuit of activities in another Member State, which the second sentence of the first paragraph of Article 52 of the Treaty expressly confers on economic operators.

43 The difference in treatment to which branches of non-resident companies are subject in comparison with resident companies as well as the restriction of the freedom to choose the form of secondary establishment must be regarded as constituting a single composite infringement of Articles 52 and 58 of the Treaty.

44 The question which must be examined therefore is whether that difference in treatment may be justified in view of the provisions of the Treaty on freedom of establishment.

45 The German Government maintains that, as far as direct taxation is concerned, the situations of resident companies and of non-resident companies are not, as a general rule, comparable.

46 It argues that the permanent establishments of non-resident companies in Germany are in a situation which is objectively different from that of companies resident in Germany. Because of the income received through their branches in Germany and the assets held in those branches, non-resident companies are subject in Germany to limited tax liability whereas resident companies are subject in Germany to unlimited tax liability.

47 In response to that argument it must be stated that, as regards liability to tax on dividend receipts in Germany from shares in foreign subsidiaries and sub-subsidiaries and on the holding of those shares, companies not resident in Germany having a permanent establishment there and companies resident in Germany are in objectively comparable situations. First, the receipt of dividends in Germany is liable to tax there irrespective of whether the recipient is a resident company or a non-resident company, since the latter receives them through a permanent establishment located in Germany. Second, shareholdings in foreign subsidiaries and sub-subsidiaries in Germany are liable to tax there irrespective of whether they are held by a resident *company or by a non-resident company, since the latter holds such shares in a permanent establishment located in Germany.*

48 The situations of resident companies and of non-resident companies are made even more comparable by the fact that the difference in treatment applies only as regards the grant of the tax concessions in question, which allow resident companies either to deduct from corporation tax the amount of foreign tax levied on dividends from shareholdings in foreign companies or to exclude those dividends or holdings from their income and from their global assets which are taxable in Germany. The refusal to grant those advantages to non-resident companies having a permanent establishment in Germany produces the result that their tax liability, theoretically limited to `national' income and assets, comprises in actual fact dividends from foreign sources and shareholdings in foreign companies limited by shares. For the matters in question, the difference between limited tax liability and unlimited tax liability is certainly not relevant in so far as the global income and assets do not include dividends received from foreign companies or shareholdings in foreign companies, owing to the grant of the tax concessions in question, for which taxpayers subject to limited tax liability cannot qualify.

49 The German Government also argues that the refusal to allow non-resident companies having a permanent establishment in Germany certain tax concessions granted to resident companies is justified by the need to prevent a reduction in tax revenue given the impossibility for the German tax authorities to compensate for the reduction in revenue brought about by the grant of the tax concessions in question by taxing dividends distributed by non-resident companies limited by shares operating permanent establishments in Germany. The German Government explains that, although the loss of revenue occurring in a Member State as a result of the grant of the tax concessions in question is partially compensated by the taxation of the dividends distributed by the parent company (Kapitalertragsteuer, withheld at source from income from moveable capital assets, and Aktionärsteuer, share tax), the State which grants those tax concessions to the permanent establishment of a foreign company limited by shares is not so compensated because it is not involved in taxing the profits of the foreign company limited by shares.

50 It must be stated in response to that argument that a reduction of revenue due to the impossibility of partially compensating for the reduction in tax yield brought about by the grant to foreign companies having a permanent branch in Germany of the various tax concessions in question is not one of the grounds listed in Article 56 of the EC Treaty (now, after amendment, Article 46 EC) and cannot be regarded as a matter of overriding general interest which may be relied upon in order to justify unequal treatment that is in principle incompatible with Article 52 of the Treaty (see, to this effect, the judgment in ICI, cited above, paragraph 28).

51 According to the German Government, this refusal is also justified by the advantage which permanent branches enjoy in comparison with resident subsidiaries as regards the transfer of profits to the non-resident dominant or parent company.

52 It argues that, having no distinct legal personality, permanent branches cannot distribute their profits to the dominant company in the form of dividends, as independent subsidiaries do. Their profits are directly attributed to the non-resident controlling undertaking which, to the extent of those profits, is subject in Germany only to limited tax liability. As the Portuguese Government also pointed out, contrary to what happens when a subsidiary distributes profits to its parent company, repatriation of profits by a permanent establishment to its seat does not attract a withholding levy at source in Germany. The profits transferred by the permanent establishment to the dominant company are not therefore taken into account in the transfer to the dominant company. Nor are they taken into account in the event of subsequent distributions which might be made by the non-resident dominant company whereas, in the case of resident companies, the profits are still subject to taxation at a later stage in the event of distribution of dividends to shareholders.

53 In this regard, it must be observed that the difference in tax treatment between resident companies and branches cannot, however, be justified by other advantages which branches enjoy in comparison with resident companies and which, according to the German Government, will compensate for the disadvantages of not being allowed the tax concessions in question. Even if such advantages exist, they cannot justify breach of the obligation laid down in Article 52 of the Treaty to accord the same domestic treatment concerning the tax concessions in question (see, to this effect, Commission v France, cited above, paragraph 21).

54 Finally, as justification for not allowing the tax concessions in question, the German Government maintains that the conclusion of bilateral treaties with a non-member country does not come within the sphere of Community competence. Taxation of income and profits falls within the competence of the Member States, which are therefore at liberty to conclude bilateral double-taxation treaties with non-member countries. In the absence of Community harmonisation in this area, the question whether, in the case of dividends, the tax exemption for international groups should be granted to permanent establishments under a tax treaty concluded with a non-member country is not governed by Community law. To extend to other situations the tax advantages provided for by treaties concluded with non-member countries would not be compatible with the division of competences under Community law.

55 The Swedish Government observes that double-taxation treaties are based on the principle of reciprocity and that the balance inherent in such treaties would be disturbed if the benefit of their provisions was extended to companies established in Member States which were not parties to them.

56 In this regard, it must be observed first of all that, in the absence of unifying or harmonising measures adopted in the Community, in particular under the second indent of Article 220 of the EC Treaty (now the second indent of Article 293 EC), the Member States remain competent to determine the criteria for taxation of income and wealth with a view to eliminating double taxation by means, inter alia, of international agreements. In this context, the Member States are at liberty, in the framework of bilateral agreements concluded in order to prevent double taxation, to determine the connecting factors for the purposes of allocating powers of taxation as between themselves (see, to this effect, Case C-336/96 Gilly [1998] ECR I-2793, paragraphs 24 and 30).

57 As far as the exercise of the power of taxation so allocated is concerned, the Member States nevertheless may not disregard Community rules. According to the settled case-law of the Court, although direct taxation is a matter for the Member States, they must nevertheless exercise their taxation powers consistently with Community law (see ICI, cited above, paragraph 19, and the case-law cited there).

58 In the case of a double-taxation treaty concluded between a Member State and a non-member country, the national treatment principle requires the Member State which is party to the treaty to grant to permanent establishments of non-resident companies the advantages provided for by that *treaty on the same conditions as those which apply to resident companies.*

59 As the Advocate General points out in point 81 of his Opinion, the obligations which Community law imposes on the Federal Republic of Germany do not affect in any way those resulting from its agreements with the United States of America and the Swiss Confederation. The balance and the reciprocity of the treaties concluded by the Federal Republic of Germany with those two countries would not be called into question by a unilateral extension, on the part of the Federal Republic of Germany, of the category of recipients in Germany of the tax advantage provided for by those treaties, in this case corporation tax relief for international groups, since such an extension would not in any way affect the rights of the non-member countries which are parties to the treaties and would not impose any new obligation on them.

60 Moreover, the German legislature has never considered that the provisions of the double-taxation treaties concluded with non-member countries precluded any unilateral renunciation by the Federal Republic of levies on dividends from shareholdings in foreign companies since, in adopting the Standortsicherungsgesetz of 13 September 1993, it unilaterally extended the corporation tax concessions to permanent establishments of non-resident companies and thus ended the difference in tax treatment in relation to companies having their seat or business management in Germany.

61 The Swedish Government, in its written observations, argued that in certain extreme situations extending the scope of bilateral double-taxation treaties could lead to no tax yield being produced at all.

62 As the Advocate General points out in point 88 of his Opinion, such an argument is not relevant in the case referred since it has not been argued that there was a risk that profits would not be taxed in any country.

63 Consequently, the answer to be given to the Finanzgericht must be that Articles 52 and 58 of the Treaty preclude the exclusion of a permanent establishment in Germany of a company limited by shares having its seat in another Member State from enjoyment, on the same conditions as those applicable to companies limited by shares having their seat in Germany, of tax concessions taking the form of:

- an exemption from corporation tax for dividends received from companies established in non-member countries (corporation tax relief for international groups), provided for by a treaty for the avoidance of double taxation concluded with a non-member country,

- the crediting, against German corporation tax, of the corporation tax levied in a State other than the Federal Republic of Germany on the profits of a subsidiary established there, provided for by German legislation, and

- an exemption from capital tax for shareholdings in companies established in non-member countries (capital tax relief for international groups), also provided for by German legislation.

1 By order of 30 June 1997, received at the Court on 2 September 1997, the Finanzgericht Köln (Finance Court, Cologne) referred to the Court for a preliminary ruling under Article 177 of the EC Treaty (now Article 234 EC) three questions on the interpretation of Article 52 of the EC Treaty (now, after amendment, Article 43 EC) and Article 58 of the EC Treaty (now Article 48 EC).

2 The three questions have been raised in proceedings between Compagnie de Saint-Gobain, Zweigniederlassung Deutschland (hereinafter `Saint-Gobain ZN'), and the Finanzamt (Tax Office) Aachen-Innenstadt (hereinafter `the Finanzamt').

3 Saint-Gobain ZN is the German branch of Compagnie de Saint-Gobain SA (hereinafter `Saint-Gobain SA'), which is a company incorporated under French law whose seat and business management are located in France.

4 For the purposes of German tax law, Saint-Gobain ZN, which is entered in the commercial register in Germany, is treated as a permanent establishment of Saint-Gobain SA.

5 In Germany, Saint-Gobain SA is subject to limited tax liability because neither its seat nor its business management are located in that State. This limited tax liability of Saint-Gobain SA relates to both the income earned in Germany through its permanent establishment, under Paragraph 2(1) of the Körperschaftsteuergesetz (Law on Corporation Tax, hereinafter `the KStG'), and the assets held in its permanent establishment, under Paragraph 2(1)(2) and 2(2) of the Vermögensteuergesetz (Law on Capital Tax, hereinafter `the VStG').

6 Under the combined provisions of Paragraph 8(1) of the KStG and Paragraph 49(1)(2)(a) of the Einkommensteuergesetz (Law on Income Tax, hereinafter `the EStG'), income from an industrial and commercial establishment located within German territory forms part of domestic income, within the meaning of limited tax liability.

7 Furthermore, under Paragraph 121(2)(3), of the Bewertungsgesetz (Law on the Evaluation of Assets, hereinafter `the BewG'), domestic operating capital forms part of the domestic assets of a taxpayer subject to limited tax liability, which includes in particular the capital used in the establishment which the taxpayer exploits within German territory.

8 The Finanzamt refused to grant Saint-Gobain SA certain tax concessions relating to the taxation of dividends from shares in foreign companies limited by shares, those concessions being restricted to companies subject in Germany to unlimited tax liability.

9 In 1988, the relevant year in the main proceedings, Saint-Gobain SA held, through the operating capital of its German branch, Saint-Gobain ZN, the following shareholdings:

- 10.2% of the shares of the company Certain Teed Corporation, established in the United States of America;

- 98.63% of the share capital of the company Grünzweig & Hartmann AG (hereinafter `Grünzweig'), established in Germany;

- 99% of the share capital of the company Gevetex Textilglas GmbH (hereinafter `Gevetex'), established in Germany.

10 The subsidiaries of Saint-Gobain SA which are established in Germany, namely Grünzweig and Gevetex, are bound to Saint-Gobain ZN by an agreement on treatment as a single entity for tax purposes (`Organvertrag') under Paragraph 18 of the KStG. In the case of a group treated as a single entity for German tax purposes (`Organschaft'), the parent company (the dominant company or `Organträger') of a group of companies declares that it is solely liable for the tax on the group's aggregate out-turn. The profits and losses of the minor companies (`Organgesellschaften') are incorporated in the profits and losses of the dominant company and, where appropriate, subject to the tax for which the latter company is liable, on condition that the minor German companies are financially, economically and organisationally integrated into a German undertaking - or, on certain conditions, into the permanent establishment in Germany of a foreign company, as is the case with the Saint-Gobain group - and that there is a profit-transfer agreement between the minor companies and the dominant company (`Gewinnabführungsvertrag') lasting at least five years (Paragraph 14 of the KStG).

11 The profits of Grünzweig and Gevetex, which were transferred to Saint-Gobain ZN during 1988 under such profit-transfer agreements, included group dividends distributed by foreign subsidiaries.

12 In 1988, Grünzweig received dividends from the companies Isover SA, established in Switzerland, and Linzer Glasspinnerei Franz Haider AG, established in Austria, in which it held, in 1988, 33.34% and 46.67% respectively of their shares.

13 In that same year, Gevetex received dividends from an Italian subsidiary, the company Vitrofil SpA, in which it had a 24.8% shareholding.

14 It appears from the national court's file that the other conditions relating to tax integration were fulfilled, so that those dividends were, in accordance with German tax law, directly attributed to the permanent establishment situated within German territory (Saint-Gobain ZN) and therefore to the income of the dominant company (Saint-Gobain SA) subject to limited tax liability (Paragraphs 14 and 18 of the KStG).

15 Saint-Gobain ZN is challenging before the Finanzgericht the refusal of the Finanzamt to grant it three tax concessions designed to prevent dividends which are received in Germany by companies with shareholdings in foreign companies and which have already been taxed abroad from being taxed again in Germany.

16 First, the Finanzamt refused to grant an exemption from German corporation tax for the dividends received by Saint-Gobain ZN from the United States of America and Switzerland on the ground that the treaties for the avoidance of double taxation concluded between the Federal Republic of Germany and each of those two non-member countries, which provide for such exemption, restrict it to, respectively, German companies and companies subject in Germany to unlimited tax liability. The concession concerned is a form of international group relief from corporation tax in respect of profits distributed between parent company and subsidiary (`internationales Schachtelprivileg').

17 Article XV of the old convention concluded between the Federal Republic of Germany and the United States of America for the avoidance of double taxation with respect to taxes on income and to certain other taxes, of 22 July 1954, as amended by the Protocol of 17 September 1965 (BGBl. 1954 II, p. 1118; 1966 II, p. 745), in force at the relevant time, provides:

`(1) It is agreed that double taxation shall be avoided in the following manner:

(a) ...

(b) 1. Federal Republic tax shall be determined in the case of a natural person resident in the Federal Republic or of a German company as follows:

(aa) ... there shall be excluded from the basis upon which Federal Republic tax is imposed any item of income from sources within the United States or any item of capital situated within the United States which, according to this Convention, is not exempt from tax by the United States. ... The first sentence shall, in the case of income from dividends, apply only to such dividends subject to tax under United States law as are paid to a German company limited by shares (Kapitalgesellschaft) by a United States corporation, at least 25 percent of the voting shares of which are owned directly by the first-mentioned company ...'.

According to Article II(1)(f) of the same Convention, `German company' means a juridical person having its business management or seat in Germany.

18 Article 24 of the Convention concluded on 11 August 1971 between the Federal Republic of Germany and the Swiss Confederation for the avoidance of double taxation with respect to taxes on income and capital, as amended by the Protocol of 30 November 1978 (BGBl. 1972 II, p. 1022; 1980 II, p. 750), provides, in the version which was in force in relation to taxes collected before 1990:

`(1) As regards a person established in the Federal Republic of Germany, double taxation shall be avoided in the following manner:

(1) The following income, originating in Switzerland, which, according to the preceding articles, is taxable in Switzerland, shall be excluded from the basis on which German tax is imposed:

(a) ...

(b) The dividends, within the meaning of Article 10, which a company limited by shares established in Switzerland distributes to a company limited by shares subject to unlimited tax liability in the Federal Republic of Germany where, according to German tax legislation, a Swiss tax levied on the profits of the distributing company could also be credited against German corporation tax to be levied on the German company.'

19 Second, although the Finanzamt allowed Saint-Gobain SA the direct credit provided for in Paragraph 26(1) of the KStG and therefore credited against the German corporation tax payable by Saint-Gobain SA on dividends received through Saint-Gobain ZN the foreign tax which it had already paid and which had been withheld at source in the various countries in which the distributing companies are established, it refused a credit for the foreign corporation tax levied on the profits distributed by the foreign subsidiaries and sub-subsidiaries of Saint-Gobain SA in the countries in which they are established (indirect credit, also called `indirect tax credit', which is provided for in Paragraph 26(2) of the KStG) because the law restricts that concession to companies subject in Germany to unlimited tax liability.

20 Paragraph 26(2) of the KStG lays down the rules on indirect credit:

`(2) If, for at least 12 months before the balance-sheet date ... a company ... (parent company) having unlimited tax liability ... has held directly and uninterruptedly a share of at least one tenth in the nominal share capital of a company limited by shares having its management and its seat outside the territorial scope of this Law (subsidiary company) ... the parent company may, upon application, also be allowed to credit against the corporation tax for which it is liable in respect of dividends distributed to it by the subsidiary a tax on the profits of the latter company. The credit shall relate to a fraction of the tax analogous to the German corporation tax which the subsidiary

paid in respect of the financial year for which it made the distribution'.

21 Third, the Finanzamt included the shareholding in the American subsidiary in the domestic assets of the permanent establishment, taxable by way of capital tax, and did not therefore allow Saint-Gobain SA the capital tax concession for international groups provided for by Paragraph 102(2) of the BewG since that Law restricts that concession to domestic companies limited by shares.

22 Paragraph 102(2) of the BewG provides:

`(2) If a German company limited by shares ... has a direct holding in the nominal share capital of a company limited by shares having its seat and business management outside the scope of this Law (subsidiary company) and that holding is at least 10%, that holding shall, upon application, be excluded from the company's business assets, provided that the shareholding has existed uninterruptedly for at least 12 months before the relevant balance-sheet date ...'.

23 Saint-Gobain SA considers that it is contrary to the combined provisions of Articles 52 and 58 of the Treaty for the German permanent establishment of a company limited by shares established in France to be excluded from the benefit of the tax concessions described above (indirect credit and corporation-tax relief and capital-tax relief for international groups).

24 The Finanzgericht Köln found that, under applicable German law as it stood in 1988, those concessions could be denied to a German permanent establishment of a foreign company limited by shares. However, it considered that having regard in particular to the judgment in Case 270/83 Commission v France [1986] ECR 273, paragraph 18, a refusal to allow the concessions could constitute discrimination contrary to Article 52 of the Treaty.

25 It should be explained that the domestic legal context was changed, with effect from the 1994 tax period, by the Standortsicherungsgesetz (Law to Maintain and Improve the Attraction of the Federal Republic as a Site for Business) of 13 September 1993, BGBl. I, p. 1569), which introduced Paragraph 8b(4) and Paragraph 26(7) into the KStG.

26 Paragraph 8b(4) of the KStG (shareholdings in foreign companies) provides:

`(4) Shares of profits which are distributed by a foreign company in respect of shares which are to be attributed to a German permanent business establishment of a company subject to limited tax liability shall not be taken into account in the calculation of the income to be attributed to the German permanent business establishment if, under a treaty for the avoidance of double taxation ..., they would be exempt if the company subject to limited tax liability were subject to unlimited tax liability. ... If the exemption or the concession depends on the holding of the share for a minimum period, the shareholding during that period must also have belonged to the operating assets of the German permanent business establishment'.

27 Paragraph 26(7) of the KStG, in the version in force as from the 1994 tax period, which extends the indirect credit provided for in Paragraph 26(2) of the KStG to German branch establishments, provides:

`Subparagraphs (2) and (3) shall be applicable by analogy to shares of profits which a German branch establishment of a company subject to limited tax liability receives from a foreign subsidiary if the conditions laid down in the first and third sentences of Paragraph 8b(4) are fulfilled.'

28 According to the information provided by the Finanzgericht, the legislature explained the reason for the amendment thus:

`The German branch establishment of a company subject to limited tax liability is thus assimilated to a German company. The equal treatment between the permanent establishment of a foreign

company and a company subject to unlimited tax liability takes into account the freedom of establishment provided for in Article 52 of the EEC Treaty and excludes discrimination prohibited by those provisions' (Bundesrats Drucksache 1/93, pp. 40 and 41).

29 However, the changes made to the national legislation did not take effect until after the 1994 tax period (Paragraph 54(1) of the KStG, in the version applicable under the Law of 13 September 1993) and cannot therefore be taken into account in the main proceedings.

30 It should also be pointed out that the Standortsicherungsgesetz of 13 September 1993 has not amended Paragraph 102 of the BewG on intercorporate capital tax relief. However, according to the Commission, which was not contradicted on this point at the hearing, capital tax has not been levied since 1 January 1997 on the ground that it is in part unconstitutional, as found by the Bundesverfassungsgericht (Federal Constitutional Court) in its judgment of 22 June 1995 (2 BvL 37/91 BVerfGE 93, 121). Paragraph 102 of the BewG was repealed by Paragraph 6(14) and 6(15) of the Gesetz zur Fortsetzung der Unternehmenssteuerreform (Law on the Furtherance of Corporation Tax Reform) of 29 October 1997 (BGBl. I, p. 2590).

31 In those circumstances, the Finanzgericht Köln decided to stay proceedings and to refer the following questions to the Court for a preliminary ruling:

`(1) Is it compatible with the applicable Community law, and in particular with Articles 52 and 58 of the EC Treaty, read together, for a branch establishment in Germany of a company having its seat in another Member State not to be accorded Schachtelprivileg [a form of tax relief in respect of profits distributed between parent company and subsidiary] in respect of dividends under a double-taxation agreement with a non-member State under the same conditions as for a company having its seat in Germany?

(2) Is it compatible with the applicable Community law, and in particular with Articles 52 and 58 of the EC Treaty, read together, for the tax levied in a non-member State on the profits of a subsidiary in that State of a branch establishment in Germany of a company having its seat in another Member State not to be credited against the German corporation tax on that German branch establishment under the same conditions as for a company having its seat in Germany?

(3) Is it compatible with the applicable Community law, and in particular with Articles 52 and 58 of the EC Treaty, read together, for a branch establishment in Germany of a company having its seat in another Member State not to be accorded Schachtelprivileg in respect of capital tax under the same conditions as for a company having its seat in Germany?'

32 By its three questions, which it is appropriate to examine together, the Finanzgericht is asking essentially whether Articles 52 and 58 of the Treaty preclude the exclusion of a permanent establishment in Germany of a company limited by shares having its seat in another Member State (hereinafter `the non-resident company') from enjoyment, on the same conditions as those applicable to companies limited by shares having their seat in Germany, of tax concessions taking the form of:

- an exemption from corporation tax for dividends received from companies established in non-member countries (corporation tax relief for international groups), provided for by a treaty for the avoidance of double taxation concluded with a non-member country,

- the crediting, against German corporation tax, of the corporation tax levied in a State other than the Federal Republic of Germany on the profits of a subsidiary established there, provided for by German legislation, and

- an exemption from capital tax for shareholdings in companies established in non-member countries (capital tax relief for international groups), also provided for by German legislation.

33 According to settled case-law, Article 52 of the Treaty constitutes a fundamental provision which has been directly applicable in the Member States since the end of the transitional period (see, in particular, the judgments in Case 71/76 Thieffry [1977] ECR 765, Commission v France, cited above, paragraph 13, and Case C-311/97 Royal Bank of Scotland [1999] ECR I-0000, paragraph 22).

34 The freedom of establishment conferred by Article 52 of the Treaty on nationals of Member States of the Community, which entails for them access to, and pursuit of, activities as employed persons and the forming and management of undertakings on the same conditions as those laid down for its own nationals by the laws of the Member State where establishment is effected, includes, pursuant to Article 58 of the Treaty, the right of companies or firms formed in accordance with the laws of a Member State and having their registered office, central administration or principal place of business within the Community to pursue their activities in the Member State concerned through a branch or an agency (see Case C-264/96 ICI [1998] ECR I-4695, paragraph 20, and the case-law cited there). Those two provisions guarantee nationals of Member States of the Community who have exercised their freedom of establishment and companies or firms which are assimilated to them the same treatment in the host Member State as that accorded to nationals of that Member State.

35 As far as companies or firms are concerned, their corporate seat, in the sense expressed above, serves to determine, like nationality for natural persons, their connection to a Member State's legal order (see ICI, cited above, paragraph 20, and the case-law cited there).

36 The practice in question in the main proceedings consists in refusing to grant to a non-resident company limited by shares, which operates a branch in Germany through which it holds shares in companies established in States other than the Federal Republic of Germany and through which it receives dividends on such shares, certain concessions in relation to the taxation of those shareholdings or those dividends which are restricted to companies subject in Germany to unlimited tax liability, either under domestic tax legislation or under bilateral treaties for the avoidance of double taxation concluded with non-member countries.

37 It should be explained here that companies subject to unlimited tax liability in Germany are, under German law, companies considered to be resident in Germany for tax purposes, that is to say companies which have their registered office or business management in Germany (Paragraph 1 of the KStG). The refusal to grant the tax concessions in question therefore affects in principle companies not resident in Germany and is based on the criterion of the company's corporate seat in determining the tax rules applying in Germany to shareholdings in companies limited by shares established in States other than the Federal Republic of Germany and to dividends from such shareholdings.

38 It is not contested that, for those companies to which they are granted, the tax concessions represented by corporation tax relief for international groups and by indirect credit result in a lighter tax burden, so that the permanent establishments of companies having their corporate seat in another Member State (`non-resident companies') which cannot qualify for them are in a less favourable situation than resident companies, including German subsidiaries of non-resident companies.

39 However, as far as capital tax is concerned, the German Government argues that the situation of the permanent establishment of a non-resident company not allowed the concession for international groups is not less favourable than that of the resident subsidiary of a non-resident company which does receive this tax concession since the tax burden on the non-resident *company (parent or dominant company) is the same irrespective of whether shareholdings are held through a permanent establishment or through a subsidiary. For capital tax purposes, a shareholding in a foreign sub-subsidiary is included in the assets of the permanent establishment and is therefore taxed as an asset of the dominant company. Secondly, if the shareholding in a foreign sub-subsidiary is excluded from the subsidiary's assets by the international group concession, the assets of the non-resident parent company will include the value of its shareholding in the subsidiary held in Germany, evaluated with account taken of the value of the shares which it holds itself in the sub-subsidiary, pursuant to Paragraph 121(2)(4) of the BewG, in force at the relevant time. The German subsidiary's shareholding in a foreign sub-subsidiary is therefore also taxed as an asset of the parent company not resident in Germany.*

40 However, at the hearing Saint-Gobain ZN explained, without being contradicted on this point, that the application of Paragraph 121(2)(4) of the BewG had been set aside in its case by virtue of Article 19 of the treaty for the avoidance of double taxation concluded between the Federal Republic of Germany and the French Republic on 21 July 1959 (JORF of 8 November 1961, p. 10230, amended on 9 June 1969, JORF of 22 November 1970, p. 10725), the effect of which is to exclude taxation, as an asset of the parent company not resident in Germany, of the shareholding held by a German subsidiary in a foreign sub-subsidiary. According to Saint-Gobain ZN, the German rules governing the grant of capital tax exemption for international groups therefore produce a tax burden on a permanent establishment of a foreign company which is different from that on a subsidiary of a foreign company.

41 As far as this point is concerned, it is for the Finanzgericht to determine, in the case before it, whether the refusal to grant capital tax exemption for international groups to the permanent establishments of French companies puts them in a situation less favourable than that of German subsidiaries of French companies.

42 In those circumstances, the refusal to grant the tax concessions in question to the permanent establishments in Germany of non-resident companies makes it less attractive for those companies to have intercorporate holdings through German branches, since under German law and double-taxation treaties the tax concessions in question can only be granted to German subsidiaries which, as legal persons, are subject to unlimited tax liability, which thus restricts the freedom to choose the most appropriate legal form for the pursuit of activities in another Member State, which the second sentence of the first paragraph of Article 52 of the Treaty expressly confers on economic operators.

43 The difference in treatment to which branches of non-resident companies are subject in comparison with resident companies as well as the restriction of the freedom to choose the form of secondary establishment must be regarded as constituting a single composite infringement of Articles 52 and 58 of the Treaty.

44 The question which must be examined therefore is whether that difference in treatment may be justified in view of the provisions of the Treaty on freedom of establishment.

45 The German Government maintains that, as far as direct taxation is concerned, the situations of resident companies and of non-resident companies are not, as a general rule, comparable.

46 It argues that the permanent establishments of non-resident companies in Germany are in a situation which is objectively different from that of companies resident in Germany. Because of the income received through their branches in Germany and the assets held in those branches, non-resident companies are subject in Germany to limited tax liability whereas resident companies are subject in Germany to unlimited tax liability.

47 In response to that argument it must be stated that, as regards liability to tax on dividend receipts in Germany from shares in foreign subsidiaries and sub-subsidiaries and on the holding of *those shares, companies not resident in Germany having a permanent establishment there and companies resident in Germany are in objectively comparable situations. First, the receipt of dividends in Germany is liable to tax there irrespective of whether the recipient is a resident company or a non-resident company, since the latter receives them through a permanent establishment located in Germany. Second, shareholdings in foreign subsidiaries and sub-subsidiaries in Germany are liable to tax there irrespective of whether they are held by a resident company or by a non-resident company, since the latter holds such shares in a permanent establishment located in Germany.*

48 The situations of resident companies and of non-resident companies are made even more comparable by the fact that the difference in treatment applies only as regards the grant of the tax concessions in question, which allow resident companies either to deduct from corporation tax the amount of foreign tax levied on dividends from shareholdings in foreign companies or to exclude those dividends or holdings from their income and from their global assets which are taxable in Germany. The refusal to grant those advantages to non-resident companies having a permanent establishment in Germany produces the result that their tax liability, theoretically limited to `national' income and assets, comprises in actual fact dividends from foreign sources and shareholdings in foreign companies limited by shares. For the matters in question, the difference between limited tax liability and unlimited tax liability is certainly not relevant in so far as the global income and assets do not include dividends received from foreign companies or shareholdings in foreign companies, owing to the grant of the tax concessions in question, for which taxpayers subject to limited tax liability cannot qualify.

49 The German Government also argues that the refusal to allow non-resident companies having a permanent establishment in Germany certain tax concessions granted to resident companies is justified by the need to prevent a reduction in tax revenue given the impossibility for the German tax authorities to compensate for the reduction in revenue brought about by the grant of the tax concessions in question by taxing dividends distributed by non-resident companies limited by shares operating permanent establishments in Germany. The German Government explains that, although the loss of revenue occurring in a Member State as a result of the grant of the tax concessions in question is partially compensated by the taxation of the dividends distributed by the parent company (Kapitalertragsteuer, withheld at source from income from moveable capital assets, and Aktionärsteuer, share tax), the State which grants those tax concessions to the permanent establishment of a foreign company limited by shares is not so compensated because it is not involved in taxing the profits of the foreign company limited by shares.

50 It must be stated in response to that argument that a reduction of revenue due to the impossibility of partially compensating for the reduction in tax yield brought about by the grant to foreign companies having a permanent branch in Germany of the various tax concessions in question is not one of the grounds listed in Article 56 of the EC Treaty (now, after amendment, Article 46 EC) and cannot be regarded as a matter of overriding general interest which may be relied upon in order to justify unequal treatment that is in principle incompatible with Article 52 of the Treaty (see, to this effect, the judgment in ICI, cited above, paragraph 28).

51 According to the German Government, this refusal is also justified by the advantage which permanent branches enjoy in comparison with resident subsidiaries as regards the transfer of profits to the non-resident dominant or parent company.

52 It argues that, having no distinct legal personality, permanent branches cannot distribute their profits to the dominant company in the form of dividends, as independent subsidiaries do. Their profits are directly attributed to the non-resident controlling undertaking which, to the extent of those profits, is subject in Germany only to limited tax liability. As the Portuguese Government also pointed out, contrary to what happens when a subsidiary distributes profits to its parent company, repatriation of profits by a permanent establishment to its seat does not attract a withholding levy *at source in Germany. The profits transferred by the permanent establishment to the dominant company are not therefore taken into account in the transfer to the dominant company. Nor are they taken into account in the event of subsequent distributions which might be made by the non-resident dominant company whereas, in the case of resident companies, the profits are still subject to taxation at a later stage in the event of distribution of dividends to shareholders.*

53 In this regard, it must be observed that the difference in tax treatment between resident companies and branches cannot, however, be justified by other advantages which branches enjoy in comparison with resident companies and which, according to the German Government, will compensate for the disadvantages of not being allowed the tax concessions in question. Even if such advantages exist, they cannot justify breach of the obligation laid down in Article 52 of the Treaty to accord the same domestic treatment concerning the tax concessions in question (see, to this effect, Commission v France, cited above, paragraph 21).

54 Finally, as justification for not allowing the tax concessions in question, the German Government maintains that the conclusion of bilateral treaties with a non-member country does not come within the sphere of Community competence. Taxation of income and profits falls within the competence of the Member States, which are therefore at liberty to conclude bilateral double-taxation treaties with non-member countries. In the absence of Community harmonisation in this area, the question whether, in the case of dividends, the tax exemption for international groups should be granted to permanent establishments under a tax treaty concluded with a non-member country is not governed by Community law. To extend to other situations the tax advantages provided for by treaties concluded with non-member countries would not be compatible with the division of competences under Community law.

55 The Swedish Government observes that double-taxation treaties are based on the principle of reciprocity and that the balance inherent in such treaties would be disturbed if the benefit of their provisions was extended to companies established in Member States which were not parties to them.

56 In this regard, it must be observed first of all that, in the absence of unifying or harmonising measures adopted in the Community, in particular under the second indent of Article 220 of the EC Treaty (now the second indent of Article 293 EC), the Member States remain competent to determine the criteria for taxation of income and wealth with a view to eliminating double taxation by means, inter alia, of international agreements. In this context, the Member States are at liberty, in the framework of bilateral agreements concluded in order to prevent double taxation, to determine the connecting factors for the purposes of allocating powers of taxation as between themselves (see, to this effect, Case C-336/96 Gilly [1998] ECR I-2793, paragraphs 24 and 30).

57 As far as the exercise of the power of taxation so allocated is concerned, the Member States nevertheless may not disregard Community rules. According to the settled case-law of the Court, although direct taxation is a matter for the Member States, they must nevertheless exercise their taxation powers consistently with Community law (see ICI, cited above, paragraph 19, and the case-law cited there).

58 In the case of a double-taxation treaty concluded between a Member State and a non-member country, the national treatment principle requires the Member State which is party to the treaty to grant to permanent establishments of non-resident companies the advantages provided for by that treaty on the same conditions as those which apply to resident companies.

59 As the Advocate General points out in point 81 of his Opinion, the obligations which Community law imposes on the Federal Republic of Germany do not affect in any way those resulting from its agreements with the United States of America and the Swiss Confederation. The balance and the reciprocity of the treaties concluded by the Federal Republic of Germany with those two countries would not be called into question by a unilateral extension, on the part of the Federal Republic of

Germany, of the category of recipients in Germany of the tax advantage provided for by those treaties, in this case corporation tax relief for international groups, since such an extension would not in any way affect the rights of the non-member countries which are parties to the treaties and would not impose any new obligation on them.

60 Moreover, the German legislature has never considered that the provisions of the double-taxation treaties concluded with non-member countries precluded any unilateral renunciation by the Federal Republic of levies on dividends from shareholdings in foreign companies since, in adopting the Standortsicherungsgesetz of 13 September 1993, it unilaterally extended the corporation tax concessions to permanent establishments of non-resident companies and thus ended the difference in tax treatment in relation to companies having their seat or business management in Germany.

61 The Swedish Government, in its written observations, argued that in certain extreme situations extending the scope of bilateral double-taxation treaties could lead to no tax yield being produced at all.

62 As the Advocate General points out in point 88 of his Opinion, such an argument is not relevant in the case referred since it has not been argued that there was a risk that profits would not be taxed in any country.

63 Consequently, the answer to be given to the Finanzgericht must be that Articles 52 and 58 of the Treaty preclude the exclusion of a permanent establishment in Germany of a company limited by shares having its seat in another Member State from enjoyment, on the same conditions as those applicable to companies limited by shares having their seat in Germany, of tax concessions taking the form of:

- an exemption from corporation tax for dividends received from companies established in non-member countries (corporation tax relief for international groups), provided for by a treaty for the avoidance of double taxation concluded with a non-member country,

- the crediting, against German corporation tax, of the corporation tax levied in a State other than the Federal Republic of Germany on the profits of a subsidiary established there, provided for by German legislation, and

- an exemption from capital tax for shareholdings in companies established in non-member countries (capital tax relief for international groups), also provided for by German legislation.

Decision on costs

Costs

64 The costs incurred by the German, Portuguese and Swedish Governments and by the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

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Operative part

On those grounds,

THE COURT,

in answer to the questions referred to it by the Finanzgericht Köln by order of 30 June 1997, hereby rules:

Article 52 of the EC Treaty (now, after amendment, Article 43 EC) and Article 58 of the EC Treaty (now Article 48 EC) preclude the exclusion of a permanent establishment in Germany of a company limited by shares having its seat in another Member State from enjoyment, on the same conditions as those applicable to companies limited by shares having their seat in Germany, of tax concessions taking the form of:

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