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Judgment of the Court of 19 September 2000. - Federal Republic of Germany v Commission of the European Communities. - Aid granted to undertakings in the new German Länder - Tax provision favouring investment. - Case C-156/98.

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Keywords

1. State aid - Concept - Tax concession constituting a general measure applicable without distinction to all economic operators - Excluded

(EC Treaty, Art. 92(1) (now, after amendment, Art. 87(1) EC))

2. State aid - Concept - Renunciation of tax revenue by a Member State where it allows investors to take up holdings in certain undertakings on conditions which are in tax terms more advantageous - Fact that investors then take independent decisions - Irrelevant - Included

3. State aid - Effect on trade between Member States - Prejudicial to competition - Operating aid

4. State aid - Effect on trade between Member States - Assessment criteria - Aid for undertakings having their registered office and their central administration in one of the new Länder or in Berlin

(EC Treaty, Art. 92(1) (now, after amendment, Art. 87(1) EC))

5. State aid - Prohibition - Derogations - Aid granted to certain areas affected by the division of Germany - Scope of the derogation - Strict interpretation - Economic disadvantages resulting from the isolation created by the frontier established between the two zones

(EC Treaty, Art. 92(1) and (2)(c) (now, after amendment, Art. 87(1) and 2(c) EC))

6. State aid - Prohibition - Derogations - Aid which may be regarded as compatible with the common market - Commission's discretion - Aid to promote the development of particular areas

(EC Treaty, Art. 92(3)(a) (now, after amendment, Art. 87(3)(a) EC); Commission communication 88/C 212/02, para. 6)

7. Freedom of movement for persons - Freedom of establishment - Tax legislation - Provision of national law granting a tax advantage to undertakings having their registered office on national territory while refusing to allow undertakings having their registered office in another Member State to benefit from that advantage - Not permitted

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

8. Acts of the institutions - Statement of reasons - Obligation - Scope - Decision one of a well-established line of decisions - Summary reasoning

(EC Treaty, Art. 92(1) (now, after amendment, Art 87(1) EC) and Art. 190 (now Art. 253 EC))

Summary

1. A tax concession in favour of taxpayers who sell certain financial assets and can offset the resulting profit when they acquire other financial assets confers on them an advantage which, as a general measure applicable without distinction to all economically active persons, does not constitute aid to those taxpayers within the meaning of Article 92(1) of the Treaty (now, after amendment, Article 87(1) EC).

(see para. 22)

2. Article 92(1) of the Treaty (now, after amendment, Article 87(1) EC) provides that any aid granted by a Member State, or through State resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is incompatible with the common market. In particular, measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without therefore being subsidies in the strict meaning of the word, are similar in character and have the same effect are considered to constitute aid.

That is the case where the origin of the advantage indirectly conferred on undertakings is the renunciation by the Member State of tax revenue which it would normally have received, inasmuch as it is this renunciation which has enabled investors to take up holdings in those undertakings on conditions which are in tax terms more advantageous. The fact that investors then take independent decisions does not mean that the connection between the tax concession and the advantage given to the undertakings in question has been eliminated since, in economic terms, the alteration of the market conditions which gives rise to the advantage is the consequence of the public authorities' loss of tax revenue. It follows that such a tax concession entails a transfer of State resources.

(see paras 25-28)

3. In principle, operating aid, that is to say aid which is intended to release an undertaking from costs which it would normally have had to bear in its day-to-day management or normal activities, distorts the conditions of competition. The national authorities having failed to demonstrate that the Commission erred in its determination, the latter therefore rightly considered that aid consisting in reduction of the costs of certain financing charges for the undertakings concerned threatened to distort competition.

(see paras 29-31)

4. The relatively small amount of aid or the relatively small size of the undertaking which receives it does not as such exclude the possibility that intra-Community trade might be affected. When aid granted by the State or through State resources strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade the latter must be regarded as affected by that aid. That is the case where undertakings having their registered office and their central administration in one of the new Länder or in Berlin are granted a tax concession, since any undertaking other than those to which that measure applies can increase its own resources only on less advantageous terms, whether it is established in Germany or in another Member State.

(see paras 32-34)

5. Since Article 92(2)(c) of the Treaty (now, after amendment, Article 87(2)(c) EC), by virtue of which aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division, is compatible with the common market, has not, since the reunification of Germany, been repealed either by the Treaty on European Union or by the Treaty of Amsterdam, it cannot be presumed that that provision has been devoid of purpose since the reunification of Germany.

However, since it constitutes a derogation from the general principle, laid down in Article 92(1) of the Treaty, that State aid is incompatible with the common market, Article 92(2)(c) must be construed narrowly. Furthermore, in interpreting it, it is necessary to consider not only its wording but also the context in which it occurs and the objects of the rules of which it forms part.

In addition, although, following the reunification of Germany, Article 92(2)(c) of the Treaty falls to be applied to the new Länder, such application is conceivable only on the same conditions as those applicable in the old Länder during the period preceding the date of that reunification.

Since the phrase division of Germany refers historically to the establishment of the dividing line between the two occupied zones in 1948, the economic disadvantages caused by that division can only mean the economic disadvantages caused in certain areas of Germany by the isolation which the establishment of that physical frontier entailed, such as the breaking of communication links or the loss of markets as a result of the breaking off of commercial relations between the two parts of German territory.

By contrast, the conception according to which Article 92(2)(c) of the Treaty permits full compensation for the undeniable economic backwardness suffered by the new Länder disregards both the nature of that provision as a derogation and its context and aims. The economic disadvantages suffered by the new Länder as a whole have not been directly caused by the geographical division of Germany within the meaning of Article 92(2)(c) of the Treaty. It follows that the differences in development between the old and the new Länder are explained by causes other than the geographical rift caused by the division of Germany and in particular by the different politico-economic systems set up in each part of Germany.

(see paras 46-55)

6. As regards the application of Article 92(3) of the Treaty (now, after amendment, Article 87(3) EC), the Commission enjoys a wide discretion, the exercise of which involves assessments of an economic and social nature which must be made within a Community context.

In that connection it is clear from paragraph 6 of Commission communication 88/C 212/02 on the method for the application of Article 92(3)(a) and (b) of the Treaty to regional aid that operating aid may only exceptionally be granted in areas assisted pursuant to Article 92(3)(a), that is to say, where the aid is likely to promote a durable and balanced development of economic activity.

(see paras 67-68)

7. The freedom of establishment which Article 52 of the Treaty (now, after amendment, Article 43 EC) grants to nationals of the Member States and which entails the right for them to take up and pursue activities as self-employed persons under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected includes, pursuant to Article 58 of the Treaty (now Article 48 EC), the right of companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community to pursue their activities in the Member States concerned through a subsidiary, branch or agency. As far as companies or firms are concerned, their registered office serves to determine, like nationality for natural persons, their connection to a Member State's legal order.

Moreover, the rules regarding equal treatment prohibit not only overt discrimination by reason of nationality or, in the case of a company, its registered office, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result. It is true that discrimination can arise only through the application of different rules to comparable situations or the application of the same rule to different situations and that, in relation to direct taxes, the situations of residents and non-residents are not, as a rule, comparable.

It follows that if a Member State grants, even indirectly, a tax advantage to undertakings having their registered office on its territory, refusing to allow the undertakings having their registered office in another Member State to benefit from that advantage, the difference in treatment between the two categories will in principle be prohibited by the Treaty, provided that there is no objective difference in situation.

(see paras 81-85)

8. The reasoning required by Article 190 of the Treaty (now Article 253 EC) must show clearly and unequivocally the reasoning of the Community authority which adopted the contested measure so as to enable the persons concerned to ascertain the reasons for the measure in order to defend their rights and to enable the Court to exercise its power of review. However, the reasoning is not required to go into every relevant point of fact and law, inasmuch as the question whether a statement of reasons satisfies the requirements of Article 190 of the Treaty must be assessed with reference not only to its wording but also to its context and the whole body of legal rules governing the matter in question.

That principle, applied to the categorisation of a measure as State aid, requires the Commission to state the reasons for which the measure in question falls within the ambit of Article 92(1) of the Treaty (now, after amendment, Article 87(1) EC). Even where the very circumstances in which the aid has been granted show that it is liable to affect trade between Member States and to distort or threaten to distort competition, the Commission must at least set out those circumstances in the statement of reasons for its decision.

However, where a decision in the field of State aid was adopted in a context well known to the government concerned and it fits into a well-established line of decisions, particularly in relation to that government, such a decision may be reasoned in a summary manner.

(see paras 96-98, 105)

Parties

In Case C-156/98,

Federal Republic of Germany, represented by C.-D. Quassowski, Regierungsdirektor in the Federal Ministry of Economic Affairs, acting as Agent, assisted by K.A. Schroeter, Rechtsanwalt, Hamburg, Department E C2, 108 Graurheindorfer Strasse, D-53117 Bonn,

applicant,

v

Commission of the European Communities, represented by P.F. Nemitz and D. Triantafyllou of its Legal Service, acting as Agents, assisted by M. Hilf, Director of the Community Law Department of the University of Hamburg, with an address for service in Luxembourg at the office of C. Gómez de la Cruz, of its Legal Service, Wagner Centre, Kirchberg,

defendant,

APPLICATION for annulment of Commission Decision 98/476/EC of 21 January 1998 on tax concessions under Paragraph 52(8) of the German Income Tax Act (the Einkommensteuergesetz) (OJ 1998 L 212, p. 50),

THE COURT,

composed of: G.C. Rodríguez Iglesias, President, L. Sevón (President of Chamber), P.J.G. Kapteyn, C. Gulmann, J.-P. Puissochet, P. Jann, H. Ragnemalm, M. Wathelet (Rapporteur) and V. Skouris, Judges,

Advocate General: A. Saggio,

Registrar: D. Louterman-Hubeau, Principal Administrator,

having regard to the Report for the Hearing,

after hearing oral argument from the parties at the hearing on 9 November 1999

after hearing the Opinion of the Advocate General at the sitting on 27 January 2000,

gives the following

Judgment

Grounds

1 By application lodged at the Court Registry on 24 April 1998 the Federal Republic of Germany brought an action under the first paragraph of Article 173 of the EC Treaty (now, after amendment, Article 230 EC) for annulment of Commission Decision 98/476/EC of 21 January 1998 on tax concessions under Paragraph 52(8) of the German Income Tax Act (the Einkommensteuergesetz) (OJ 1998 L 212, p. 50, the contested decision).

The legal and factual background

The relevant Community legislation

2 The first paragraph of Article 52 of the EC Treaty (now, after amendment, the first paragraph of Article 43 EC) provides:

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be abolished by progressive stages in the course of the transitional period. Such progressive abolition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

3 Article 92(1) of the Treaty (now, after amendment, Article 87(1) EC) provides:

Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

4 In accordance with Article 92(2) of the Treaty:

The following shall be compatible with the common market:

...

(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.

5 According to Article 92(3) of the Treaty:

The following may be considered compatible with the common market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;

...

(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest ...

...

6 According to paragraph 6 of Commission communication 88/C 212/02 on the method for the application of Article 92(3)(a) and (b) to regional aid (OJ 1988 C 212, p. 2, the 1988 communication), it is only exceptionally and on certain conditions that operating aid may be granted in areas eligible under Article 92(3)(a) of the Treaty.

7 According to Commission notice 96/C 68/06 on the de minimis rule for State aid (OJ 1996 C 68, p. 9, the de minimis notice), which amends the Community guidelines of 20 May 1992 on State aid for small and medium-sized enterprises as indicated in Commission notice 92/C 213/02 (OJ 1992 C 213, p. 2), Article 92(1) of the Treaty is to be considered as not applying to aid the amount of which is below the ceiling of ECU 100 000 over a three-year period beginning when the first de minimis aid is granted. That rule does not apply to the sectors covered by the ECSC Treaty, to shipbuilding, transport or to aid granted in respect of expenditure related to agriculture or fishing.

The relevant national legislation

8 Paragraph 6b of the Einkommensteuergesetz (the EStG) allows natural persons residing in Germany and legal persons having their registered office in that Member State to transfer into certain reinvestments hidden reserves formed over a period of at least six years in certain fixed capital assets which have been revealed on the assignment of those assets for valuable consideration. In the case of the sale of shares in capital companies forming part of working capital, the second sentence of Paragraph 6b(1) permits the deduction of any profit from such sale on, in particular, the purchase of shares in capital companies, on condition that the purchase is made by a holding company within the meaning of the German Law of 17 December 1986 on holding companies. Those holding companies may deduct from the cost of purchasing new shares in capital companies 100% of the profit made on the sale of shares in capital companies.

9 The opportunities under Paragraph 6b of the EStG of carrying hidden reserves forward were increased in the 1996 annual Tax Act by the introduction into the EStG of Paragraph 52(8). This provision, which entered into force on 1 January 1996, broadens the tax concession in Paragraph 6b for the financial years 1996, 1997 and 1998. Up to 100% of the gain may be set off against the costs of purchasing new shares in capital companies, provided that the purchase is connected to an increase in capital, or the setting-up of new capital companies, and provided that such companies have both their registered office and their central administration in one of the new Länder or in Berlin, and that they have no more than 250 employees at the time the shares are acquired; the gain may also be offset where the companies are holding companies the sole object of which is, according to their own statutes, to acquire, administer or sell temporary holdings in companies which, at the time those holdings are acquired, employ no more than 250 persons and have both their registered office and central administration in one of the new Länder or in Berlin.

The contested decision

10 By letter of 13 October 1995 the German Government, in response to the Commission's express request, gave the Commission notice of the introduction of Paragraph 52(8) into the EStG.

11 By decision of 26 February 1997 the Commission initiated the procedure provided for by Paragraph 93(2) of the EC Treaty (now Article 88(2) EC) with regard to the amendment of the tax rules set out in Paragraph 6b of the EStG made by Article 52(8) thereof. At the end of the procedure the Commission adopted the contested decision.

12 It is clear from Part IV of the statement of the reasons on which the contested decision is based that the Commission considered that Article 52(8) of the EStG indirectly favoured the undertakings in the new Länder and West Berlin to which that provision applied. According to the sixth paragraph of Part IV of the contested decision, The economic advantage conferred is the greater demand for shares in the indirect beneficiary companies as compared with the legal situation

which existed before Paragraph 52(8) entered into force; investors, the direct beneficiaries, will consequently be prepared to acquire holdings in east German and Berlin companies on terms more favourable to those companies than those which would have been obtained if the measure had not been introduced. As a result, the volume of holdings in those companies will rise, or the terms of the acquisition of the holding (price as compared with nominal value, duration of holding, return on holding, etc.) will be shifted in favour of those companies, or both.

13 According to Article 1(1) of the contested decision:

The tax concession provided for in Paragraph 52(8) of the Income Tax Act constitutes State aid to companies with no more than 250 employees and having their registered office and central administration in the new Länder or West Berlin and is incompatible with the common market pursuant to Article 92(1) of the EC Treaty and Article 61(1) of the EEA Agreement.

14 Article 2(1) of the contested decision provides:

Any aid already paid under the scheme referred to in Article 1(1) is unlawful, having been granted before the Commission decision.

15 Article 2(2) requires the Federal Republic of Germany to ensure that any aid unlawfully granted is repaid.

The pleas in law put forward by the Federal Republic of Germany and the findings of the Court

16 The German Government puts forward six pleas in law in support of its application for annulment. The first two allege infringement of Article 190 of the EC Treaty (now Article 253 EC) by the contested decision and an error in law by the Commission in applying Article 92(1) of the Treaty. In the alternative, the applicant alleges failure to observe the de minimis rule, failure to take into consideration Article 92(2)(c) of the Treaty, the improper exercise of the Commission's discretion in connection with Article 92(3)(a) and (c) of the Treaty, and misinterpretation by the Commission of Article 52 of the Treaty.

Application of Article 92(1) of the Treaty

17 By its second plea in law, which it is appropriate to consider first, the German Government challenges the validity of the contested decision on the ground that the tax advantage created by Paragraph 52(8) of the EStG does not meet all the essential conditions laid down by Article 92(1) of the Treaty. In connection with this plea, the German Government considers how long the tax advantage granted lasts, the absence of any transfer of State resources, whether there is any distortion of competition and the effect of the provision of national law on trade between Member States.

18 First of all, the German Government claims that the tax concession is merely temporary. Profit from the sale of shares can be set off against the cost of acquiring new financial assets only in so far as the actual cost of those assets exceeds the amount of the profit which was offset. In its submission, the purchase of new financial assets of itself involves the creation of hidden reserves which must subsequently be disclosed and taxed.

19 Second, the German Government maintains that the fact that an undertaking is granted a financial advantage is not sufficient, where there is no transfer of resources from the State, to establish the existence of aid. Paragraph 52(8) of the EStG does not entail any such transfer, since investors receiving the tax concession provided for by that provision have no reason to pass on any part of that advantage to the undertakings in which they invest.

20 Furthermore, the German Government argues that this case may be distinguished from the situation considered in Joined Cases 67/85, 68/85 and 70/85 Van der Kooy and Others v

Commission [1988] ECR 219, where the State or public bodies were able to direct the conduct of third parties until such time as the indirect beneficiary definitively received an advantage. In the present case the decision of private investors to reinvest the profit from their sales in the purchase of holdings in a capital or holding company is quite independent, even though the tax concession provided for by Paragraph 52(8) of the EStG encourages them to act in that way.

21 Finally, the German Government claims that in the contested decision the Commission is wrong in confining itself to referring to the impossibility of excluding the risk of distortion of competition, on the one hand, and of an effect on trade between Member States, on the other.

22 It should first be stressed that it is not disputed that the tax concession in favour of taxpayers who sell certain financial assets and can offset the resulting profit when they acquire other financial assets confers on them an advantage which, as a general measure applicable without distinction to all economically active persons, does not constitute aid to those taxpayers within the meaning of the relevant provisions of the Treaty.

23 It should also be noted that the contested decision classifies the tax concession under Paragraph 52(8) of the EStG as State aid only in so far as it favours certain undertakings situated in the new Länder or West Berlin, which prevents its being a general measure of tax or economic policy.

24 Irrespective of the fact that a mere postponement of taxation may also constitute State aid (see, to that effect, Case C-256/97 DM Transport [1999] ECR I-3913), it follows that the German Government's argument that the advantage conferred by the tax concession is only temporary cannot affect the validity of the contested decision since that argument refers only to the advantages given to investors and not to those given to the undertakings in question situated in the new Länder and West Berlin.

25 Second, it is important to bear in mind that Article 92(1) of the Treaty provides that any aid granted by a Member State, or through State resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is incompatible with the common market. In particular, measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without therefore being subsidies in the strict meaning of the word, are similar in character and have the same effect are considered to constitute aid (Case C-387/92 Banco Exterior de España [1994] ECR I-877, paragraph 13, and Case C-75/97 Belgium v Commission [1999] ECR I-3671, paragraph 23).

26 In the present case it must be observed that the origin of the advantage indirectly conferred on the undertakings referred to by Paragraph 52(8) of the EStG is the renunciation by the Member State of tax revenue which it would normally have received, inasmuch as it is this renunciation which has enabled investors to take up holdings in those undertakings on conditions which are in tax terms more advantageous.

27 The fact that investors then take independent decisions does not mean that the connection between the tax concession and the advantage given to the undertakings in question has been eliminated since, in economic terms, the alteration of the market conditions which gives rise to the advantage is the consequence of the public authorities' loss of tax revenue.

28 It follows that the Commission was right to consider that the tax concession entailed a transfer of State resources.

29 Third, so far as concerns the risk of distortion of competition, it must be stated that the German Government has not demonstrated that the Commission erred in its determination that Paragraph 52(8) of the EStG had the effect of reducing the costs of certain financing charges for the

undertakings in question.

30 In principle, operating aid, that is to say aid which, like that provided for by Paragraph 52(8) of the EStG, is intended to release an undertaking from costs which it would normally have had to bear in its day-to-day management or normal activities, distorts the conditions of competition (see Case C-301/87 France v Commission [1990] (Boussac Saint Frères) ECR I-307, and Case C-86/89 Italy v Commission [1990] ECR I-3891).

31 The Commission therefore rightly considered that the aid provided for by the measure at issue threatened to distort competition.

32 As regards the effects of the provision in question on trade between Member States, the Court has consistently held that the relatively small amount of aid or the relatively small size of the undertaking which receives it does not as such exclude the possibility that intra-Community trade might be affected (Case C-142/87 Belgium v Commission [1990] (Tubemeuse) ECR I-959, paragraph 43, and Joined Cases C-278/92, C-279/92 and C-280/92 Spain v Commission [1994] ECR I-4103, paragraphs 40 to 42).

33 When aid granted by the State or through State resources strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade the latter must be regarded as affected by that aid (Case 730/79 Philip Morris Holland v Commission [1980] ECR 2671, paragraph 11, and Case C-303/88 Italy v Commission [1991] ECR I-1433, paragraph 17).

34 That is the case in this instance, since any undertaking other than those to which the measure in issue applies can increase its own resources only on less advantageous terms, whether it is established in Germany or in another Member State.

35 It follows that the Commission rightly considered that the aid introduced by the measure at issue affected trade between Member States.

36 In those circumstances the second plea put forward by the Federal Republic of Germany must be rejected.

The de minimis principle

37 By its third plea in law the German Government claims, in the alternative, that the Commission acted contrary to Community law by failing to apply the de minimis principle in the case in question.

38 The German Government maintains that because of the impossibility of quantifying the supposed financial benefit, it was not open to the Commission to exclude the application of the de minimis principle by relying on the fact that the Federal Republic of Germany had entered into no undertaking to apply the rules drawn up in the de minimis notice. In its submission, the measure in question does not lend itself to the application of the rules in that notice, which makes such an undertaking impossible. Moreover, the Commission ought to have considered that that notice was nothing more than the concrete expression of the general principle that aid of minimal importance is not to be regarded as aid incompatible with the common market.

39 It should be borne in mind that the relatively small amount of aid or the relatively small size of the undertaking which receives it does not as such exclude the possibility that the aid, in so far as it satisfies the conditions laid down by Article 92(1) of the Treaty, may be incompatible with the common market (see Tubemeuse, cited above, paragraph 43).

40 Furthermore, the aid introduced by the provision at issue does not comply with the requirements of the de minimis notice, in particular because there is no guarantee that the ECU 100 000 ceiling fixed by the notice will not be exceeded and because that provision does not exclude overlapping with other State aid.

41 The Commission was therefore entitled to consider that, in the circumstances, it was impossible to apply the rule set out in the de minimis notice.

42 It follows that the German Government's third plea must be rejected.

Application of Article 92(2)(c) of the Treaty

43 By its fourth plea, the German Government claims, in the alternative, that even if Paragraph 52(8) of the EStG does constitute State aid it would fall within the scope of the derogation provided for by Article 92(2)(c) of the Treaty.

44 It points out in that connection that that provision still applies even after the reunification of Germany. Under Article 92(2)(c) of the Treaty, a provision which confers no discretion on the Commission, the latter must confine itself to determining whether the conditions for the application of the derogation have been satisfied.

45 The German Government maintains that Paragraph 52(8) of the EStG fulfils those conditions inasmuch as that provision is necessary in order to make good the economic disadvantages borne by small and medium-sized undertakings in the former East Germany as a result of the division of Germany. When Germany was reunited, the promoters of those companies in the new Länder were unable to find the capital required for their formation.

46 It must be pointed out in this regard that under Article 92(2)(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division, is compatible with the common market.

47 After the reunification of Germany that provision was not repealed either by the Treaty on European Union or by the Treaty of Amsterdam.

48 In the light of the objective scope of the rules of Community law, the authority and effectiveness of which must be safeguarded, it cannot be presumed that that provision has been devoid of purpose since the reunification of Germany.

49 It should, however, be noted that since it constitutes a derogation from the general principle, laid down in Article 92(1) of the Treaty, that State aid is incompatible with the common market, Article 92(2)(c) must be construed narrowly.

50 Furthermore, as the Court has held in previous decisions, in interpreting a provision of Community law it is necessary to consider not only its wording but also the context in which it occurs and the objects of the rules of which it forms part (Case 292/82 Merck [1983] ECR 3781, paragraph 12, and Case 337/82 St Nikolaus Brennerei und Likörfabrik v Hauptzollamt Krefeld [1984] ECR 1051, paragraph 10).

51 In addition, although, following the reunification of Germany, Article 92(2)(c) of the Treaty falls to be applied to the new Länder, such application is conceivable only on the same conditions as those applicable in the old Länder during the period preceding the date of that reunification.

52 In this case, the phrase division of Germany refers historically to the establishment of the dividing line between the two occupied zones in 1948. Therefore, the economic disadvantages

caused by that division can only mean the economic disadvantages caused in certain areas of Germany by the isolation which the establishment of that physical frontier entailed, such as the breaking of communication links or the loss of markets as a result of the breaking off of commercial relations between the two parts of German territory.

53 By contrast, the conception advanced by the German Government, according to which Article 92(2)(c) of the Treaty permits full compensation for the undeniable economic backwardness suffered by the new Länder, disregards both the nature of that provision as a derogation and its context and aims.

54 The economic disadvantages suffered by the new Länder as a whole have not been directly caused by the geographical division of Germany within the meaning of Article 92(2)(c) of the Treaty.

55 It follows that the differences in development between the original and the new Länder are explained by causes other than the geographical rift caused by the division of Germany and in particular by the different politico-economic systems set up in each part of Germany.

56 Since the German Government has not established that the contested measure was necessary in order to make good an economic disadvantage caused by the division of Germany, in the sense defined in paragraph 52 above, no breach of Article 92(2)(c) has been established.

57 In those circumstances, the German Government's fourth plea in law cannot be accepted.

Application of Article 92(3)(a) and (c) of the Treaty

58 Again in the alternative, the German Government maintains by its fifth plea that, supposing that Paragraph 52(8) of the EStG were considered to be aid capable of affecting trade between Member States and not covered by the derogation provided for in Article 92(2)(c) of the Treaty, the aid would have to be declared compatible with the common market pursuant to Article 92(3)(a) and (c) of the Treaty. It complains that the Commission acted in excess of its powers in taking the view that the conditions laid down in Article 92(3)(a) and (c) of the Treaty were not satisfied by the contested measure.

59 It points out that the Commission, while acknowledging that the five new Länder of Brandenburg, Mecklenburg-Western Pomerania, Saxony, Saxony-Anhalt and Thuringia were designated as assisted areas pursuant to Article 92(3)(a) of the Treaty until the end of 1999, considers that the contested measure is not compatible with the common market. By so doing, the Commission misinterprets the requirements of that provision.

60 The German Government claims, first, that the Commission errs in law in classifying the contested measure as operating aid, which could only in exceptional circumstances be declared compatible with the common market, even in the case of the areas eligible under Article 92(3)(a) of the Treaty. Valuable consideration is always in fact given for the acquisition of shares in capital companies.

61 Second, it submits that the Commission is wrong to claim that the aid scheme makes it impossible to prevent the capital thus made available from being deflected to the large undertakings to which the undertakings referred to in Paragraph 52(8) of the EStG belong or to undertakings established outside the assisted areas. In its view, the Commission is equally wrong to consider that it is not impossible that the scheme should be applied to undertakings in sensitive industries or to undertakings in difficulties.

62 In that regard, the German Government maintains that an investor is hardly likely to take up a holding in a capital company belonging to a large undertaking which generally possesses the

capital necessary for its activities and has no interest in third parties' investing in its subsidiary. Furthermore, the Commission failed to ascertain, as it ought to have done, whether in the usual practice of such investments there was the slightest possibility that an investor might, in order to receive a tax concession, take up holdings in undertakings operating in sensitive economic sectors burdened with structural problems or overcapacity. The Commission is also wrong to consider that it is not inconceivable that an investor should take up a holding in an undertaking in difficulties. Finally, the argument put forward by the Commission in the contested decision that the recipient companies might invest outside the assisted areas seems wholly hypothetical. In any event, if the result were to be a widening of investment, that would be to the benefit of the area in which the undertakings were established; those undertakings would thereby be strengthened.

63 As regards companies having their registered office and central administration in West Berlin, the German Government submits that the Commission has excluded the contested measure from the ambit of Article 92(3)(c) of the Treaty only by relying on the mistaken premiss that operating aid was in issue, which is permissible only in the areas eligible under Article 92(3)(a) of the Treaty, which West Berlin is not. According to the German Government, the advantage conferred on the undertakings covered by Paragraph 52(8) of the EStG cannot be classified as operating aid.

64 As a preliminary point, it should be borne in mind that, as has been noted in paragraph 30 above, the aid scheme in issue must be regarded as granting operating aid to the recipient undertakings and, in consequence, the German Government's argument that the shares are always acquired for valuable consideration cannot negate the favourable nature of the conditions under which those undertakings are financed.

65 As regards West Berlin, an area covered by the aid scheme established by Paragraph 52(8) of the EStG, it is common ground that it has benefited from its status of assisted area by virtue of Article 92(3)(c) of the Treaty, in part until 1996 and wholly for 1997 to 1999. On the other hand, it is also common ground that during the material period West Berlin was not an assisted area for the purposes of Article 92(3)(a) of the Treaty.

66 It follows that the Commission was entitled to consider that the disputed measure, as it was applied to undertakings established in West Berlin, cannot in the light of the derogation provided for by Article 92(3)(a) of the Treaty be regarded as compatible with the common market.

67 So far as concerns the other areas covered by the aid scheme in issue, it should be noted that the Court has consistently held that as regards the application of Article 92(3) of the Treaty the Commission enjoys a wide discretion, the exercise of which involves assessments of an economic and social nature which must be made within a Community context (Case C-303/88 Italy v Commission, cited above, paragraph 34).

68 As regards the exercise of the Commission's discretion, it is clear from paragraph 6 of the 1988 communication, the meaning of which has not been challenged by the German Government, that operating aid may only exceptionally be granted in areas assisted pursuant to Article 92(3)(a) of the Treaty, that is to say, where the aid is likely to promote a durable and balanced development of economic activity.

69 As is clear from Part V of the contested decision, the Commission rightly considered in the circumstances of this case that application of the aid scheme in issue did not ensure that the recipient undertakings would use the capital provided for the development of economic activity in areas eligible under Article 92(3)(c) of the Treaty and that there was nothing to prevent the scheme from being applied to undertakings in difficulties or operating in sensitive industries for which specific State aid rules have been laid down.

70 In those circumstances, the German Government has not adduced the evidence which would justify the conclusion that the Commission exceeded the bounds of its discretion when it

considered that the aid scheme provided for by Paragraph 52(8) of the EStG did not satisfy the conditions which would enable it to fall within the scope of the derogation under Article 92(3)(a) of the Treaty.

71 It follows that the Commission made no manifest error of assessment in considering that the aid scheme introduced by the contested measure did not fall within the scope of Article 92(3)(a) or (c) of the Treaty and consequently the plea in law alleging misinterpretation of that provision must also be rejected.

Article 52 of the Treaty

72 By its sixth plea, the German Government challenges the Commission's finding that Paragraph 52(8) of the EStG infringes Article 52 of the Treaty.

73 It claims that Paragraph 52(8) of the EStG contains neither overt nor covert discrimination liable to prejudice freedom of establishment, since that provision does not use the undertakings' nationality as a criterion for drawing distinctions, the tax advantage it introduces being limited to holdings in the capital of undertakings established in a certain part of Germany, with the result that undertakings established elsewhere in Germany do not receive that tax advantage.

74 In addition, it argues that the Court's decisions, according to which Article 52 of the Treaty may also be infringed where there are non-discriminatory obstacles to the establishment in a Member State of Community nationals of other Member States, are not applicable in the circumstances of this case. Such obstacles are prohibited only where the host Member State either refuses to recognise diplomas obtained in another Member State or refuses to authorise a second establishment because the first is situated in another Member State. The contested measure concerns neither of those two situations.

75 The German Government adds that, in any event, the Commission cannot supply for a decision adopted pursuant to Article 93(2) of the Treaty alternative reasons based on Article 52 of the Treaty where the conditions under Article 92 for declaring the aid unlawful have not been satisfied. Inasmuch as there is no infringement of Article 92 of the Treaty, a decision adopted pursuant to Article 93(2) must be annulled, whether or not there is an infringement of Article 52.

76 In this regard, the Court would observe that it is not disputed that if the Commission reaches the conclusion that a measure does not constitute aid within the meaning of Article 92 of the Treaty, it cannot have recourse to the procedure under Article 93 in order to decide that another provision of the Treaty, such as Article 52, has been infringed.

77 That is not, however, the case in this instance since the Commission reached the conclusion that the disputed measure was indeed aid for the purposes of Article 92 of the Treaty and that it had, therefore, to consider whether the measure was compatible with the common market.

78 As the Court has consistently held, it is clear from the general scheme of the Treaty that the procedure under Article 93 must never produce a result which is contrary to the specific provisions of the Treaty. State aid, certain conditions of which contravene other provisions of the Treaty, cannot therefore be declared by the Commission to be compatible with the common market (see, to that effect, Case 73/79 Commission v Italy [1980] ECR 1533, paragraph 11, and Case C-225/91 Matra v Commission [1993] ECR I-3203, paragraph 41).

79 In those circumstances, the Commission was right to consider whether Paragraph 52(8) of the EStG infringed Article 52 of the Treaty.

80 It must be borne in mind in this regard that, although direct taxation is a matter for the Member States, they must nevertheless exercise their direct taxation powers consistently with Community

law (see Case C-107/94 Asscher v Staatssecretaris van Financiën [1996] ECR I-3089, paragraph 36, and Case C-264/96 ICI v Colmer (HMIT) [1998] ECR I-4695, paragraph 19).

81 According to established case-law, the freedom of establishment which Article 52 grants to nationals of the Member States and which entails the right for them to take up and pursue activities as self-employed persons under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected includes, pursuant to Article 58 of the Treaty, the right of companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community to pursue their activities in the Member States concerned through a subsidiary, branch or agency (see ICI, cited above, paragraph 20; Case C-254/97 Baxter and Others [1999] ECR I-4809, paragraph 9, and Case C-307/97 Saint-Gobain ZN v Finanzamt Aachen-Innenstadt [1999] ECR I-6161, paragraph 35).

82 As far as companies or firms are concerned, their registered office, as indicated above, serves to determine, like nationality for natural persons, their connection to a Member State's legal order (Case C-307/97 Saint-Gobain, cited above, paragraph 36).

83 It also follows from the case-law of the Court (see Case C-330/91 The Queen v Inland Revenue Commissioners, ex parte Commerzbank [1993] ECR I-4017, paragraph 14, and Case C-254/97 Baxter and Others, cited above, paragraph 10) that the rules regarding equal treatment prohibit not only overt discrimination by reason of nationality or, in the case of a company, its registered office, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result.

84 It is admittedly true that, according to the Court's case-law, discrimination can arise only through the application of different rules to comparable situations or the application of the same rule to different situations and that, in relation to direct taxes, the situations of residents and non-residents are not, as a rule, comparable (Case C-279/93 Schumacker [1995] ECR I-225, paragraphs 30 and 31).

85 It follows that if a Member State grants, even indirectly, a tax advantage to undertakings having their registered office on its territory, refusing to allow the undertakings having their registered office in another Member State to benefit from that advantage, the difference in treatment between the two categories will in principle be prohibited by the Treaty, provided that there is no objective difference in situation (Asscher, cited above, paragraph 42).

86 There can, however, be no such objective difference of situation between a company established in a Member State other than the Federal Republic of Germany and carrying on economic activity in the new Länder through a branch, agency or fixed establishment, a company which cannot claim the benefit of the contested measure, and a company having its registered office on German territory, which does profit from the tax concession introduced by that measure.

87 Since such a difference of treatment has been in no way justified, it is evident from the foregoing considerations that the Commission was right to reach the conclusion that Paragraph 52(8) of the EStG constituted discrimination prohibited by Article 52 of the Treaty.

88 Having regard to the foregoing, and since the German Government's plea alleging breach of Article 92 of the Treaty has not been upheld, the plea alleging that there has been no breach of Article 52 cannot be upheld either.

The obligation to state reasons

89 By its first plea, which it is appropriate to consider last, the German Government claims that the Commission did not give adequate reasons for the contested decision. This plea falls into five

parts.

90 In the first part of its first plea, the German Government submits that it is not possible to tell from the statement of reasons in the contested decision what constitutes the element of aid in the tax scheme in question or how that element should be quantified.

91 It complains that the Commission used three different variations in its definition of the element of aid. First, the Commission relied on a comparison of the conditions under which an undertaking covered by Paragraph 52(8) of the EStG might obtain a contribution of capital depending on whether or not it receives the tax advantage in question. Next, the Commission asserts - an assertion which is not demonstrated in the contested decision - that an investor receiving the tax advantage transfers part of it to the undertaking in which it takes a holding. Finally, the Commission considers that the aid is quantified by the amount of capital made available to the undertaking by the investor when he takes up the holding, but does not explain how such an investment constitutes the grant of aid from State resources.

92 By the second part of that plea, the German Government maintains that the Commission failed to give sufficient reasons for its allegation that there existed a risk of distortion of competition and obstacles to trade between Member States. First, it claims that the Commission merely alleges that there is such a risk of distortion of competition, relying only on the national tax scheme's character of State aid, instead of distinctly demonstrating the existence of such a risk, required by Article 92 if it is to be declared incompatible, whereas the fact is that that is an element constituting aid. Second, it claims that the Commission cannot merely, as in this instance, assert that the small amount of the aid is not sufficient to exclude the risk of effects on trade between Member States, without setting out the reasons for which it considers that the aid in issue would actually affect trade between Member States.

93 In the third part of the same plea, the German Government submits that the Commission ought to have considered on its own initiative whether the conditions under which Paragraph 52(8) of the EStG might be covered by the scope of the derogation provided for by Article 92(2)(c) of the Treaty were satisfied, an obligation not fulfilled by the contested decision. In addition, the decision does not make it possible to understand why the Commission claims that the national tax scheme is not necessary in order to offset the economic disadvantages caused by the division of Germany. In any event, the Commission ought to have asked the German Government for further information since other facts would have been necessary in order to establish whether the tax concession was required for the purposes of Article 92(2)(c) of the Treaty.

94 By the fourth part of its first plea, the German Government maintains that under Article 92(3) of the Treaty the Commission ought to have demonstrated in a comprehensible manner that it was realistic to believe that a prudent investor was liable to invest in sensitive industries or in undertakings in difficulties.

95 By the last part of that plea, the German Government considers that the contested decision is inadequately reasoned, in that it calls for the repeal of the provisions rather than their amendment, which the Commission would have been justified in doing. If the amendment of aid were sufficient to make it compatible with the common market, the requirement that the aid should be totally abolished is a disproportionate measure.

96 According to settled case-law, the reasoning required by Article 190 of the Treaty must show clearly and unequivocally the reasoning of the Community authority which adopted the contested measure so as to enable the persons concerned to ascertain the reasons for the measure and to enable the Court to exercise its power of review (Joined Cases 43/82 and 63/82 VBVB and VBBB v Commission [1984] ECR 19, paragraph 22).

97 However, the reasoning is not required to go into every relevant point of fact and law, inasmuch as the question whether a statement of reasons satisfies those requirements must be assessed with reference not only to its wording but also to its context and the whole body of legal rules governing the matter in question (Case C-56/93 Belgium v Commission [1996] ECR I-723, paragraph 86, and Case C-278/95 P Siemens v Commission [1997] ECR I-2507, paragraph 17).

98 That principle, applied to the categorisation of a measure as State aid, requires the Commission to state the reasons for which the measure in question falls within the ambit of Article 92(1) of the Treaty. Even where the very circumstances in which the aid has been granted show that it is liable to affect trade between Member States and to distort or threaten to distort competition, the Commission must at least set out those circumstances in the statement of reasons for its decision (Case 57/86 Greece v Commission [1988] ECR 2855, paragraph 15, and Joined Cases C-329/93, C-62/95 and C-63/95 Germany and Others v Commission [1996] ECR I-5151, paragraph 52).

99 As regards the element of aid, in this instance the Commission declares in the first paragraph of Part IV of the reasons for the contested decision that Paragraph 52(8) of the EStG constitutes State aid within the meaning of Article 92(1) of the EC Treaty and Article 61(1) of the European Economic Area Agreement.

100 As may be seen, from Part IV itself, the Commission clearly sets out and applies to the circumstances of the case the criteria to be satisfied if a State measure is to constitute State aid covered by Article 92(1) of the Treaty, namely that it is necessary that an economic advantage should be reserved to certain undertakings, that there should be a transfer of State resources and a risk of distorting competition or of affecting intra-Community trade.

101 With regard to the Commission's assessment of the effects of the aid introduced by the contested decision on competition and intra-Community trade, it would appear that the contested decision deduces logically from the characteristics of that measure, the purpose of which is to improve the contractual conditions under which holdings may be taken up in certain undertakings, that the application of this measure is liable to distort competition, since it makes other undertakings less attractive on the capital market, and to affect the intra-Community trade in which Community undertakings participate, whether they are recipients of or excluded from the advantage provided for by the measure in question.

102 It is clear from the statement of reasons that the Commission considered whether or not the conditions for the application of Article 92(1) of the Treaty were satisfied. In so doing, it set out the facts and the legal considerations of essential importance in the general scheme of the contested decision. That statement of reasons enables the Federal Republic of Germany and the Community judicature to understand why the Commission considered that the conditions for the application of Article 92(1) of the Treaty were satisfied in the circumstances.

103 It follows that the first and second parts of the first plea put forward by the Federal Republic of Germany must be rejected.

104 As regards the third part of the plea, the contested decision contains admittedly only a brief résumé of the grounds on which the Commission refused to apply the derogation provided for by Article 92(2)(c) of the Treaty to the facts of the case.

105 It should, however, be pointed out that the contested decision was adopted in a context well known to the German Government and that it fits into a well-established line of decisions, particularly in relation to that Government. In those circumstances, such a decision may be reasoned in a summary manner (Case 73/74 Groupement des Fabricants de Papiers Peints de Belgique and Others v Commission [1975] ECR 1491, paragraph 31).

106 In its relations with the Commission, the German Government has referred to Article 92(2)(c) of the Treaty on various occasions since 1990, insisting on the importance of that provision to the revival of the new Länder.

107 The arguments put forward in this connection by the German Government have been rejected by various decisions of the Commission, such as inter alia Commission Decision 94/266/EC of 21 December 1993 on the proposal to award aid to SST-Garngesellschaft mbH, Thüringen (OJ 1994 L 114, p. 21) and Commission Decision 94/1074/EC of 5 December 1994 on the German authorities' proposal to award aid to Textilwerke Deggendorf GmbH, Thüringen (OJ 1994 L 386, p. 13).

108 It follows that the German Government is not justified in maintaining that the statement of reasons for the contested decision did not enable it to comprehend why Paragraph 52(8) of the EStG was not covered by the derogation provided for by Article 92(2)(c) of the Treaty and that, in the absence of any specific argument put forward by the German authorities, the Commission was not required to supply a more ample statement of the reasons for its contested decision.

109 It follows that the third part of the first plea is not well founded.

110 So far as concerns the argument that the statement of reasons is inadequate with regard to the application of Article 92(3) of the Treaty, it is sufficient to point out that, by recalling the criteria laid down in the 1988 communication and by finding, in the third, fifth and sixth paragraphs of Part V of the reasons for the contested decision that in the circumstances those criteria had not been satisfied, the Commission has given reasons for its decision to the requisite legal standard. The German Government and the Community judicature are perfectly capable of discerning the reasons for which in the circumstances the Commission refused to allow the benefit of the derogations provided for by Article 92(3)(a) or (c) of the Treaty.

111 In consequence, the fourth part of the first plea is also unfounded.

112 As regards the last part of the plea, relating to the allegedly insufficient reasons given in the contested decision for inviting the German authorities to repeal Paragraph 52(8) of the EStG, it should be pointed out that it follows from the Court's previous decisions that the termination of unlawful aid is the logical consequence of the finding that it is unlawful (see, to that effect, Tubemeuse, cited above, paragraph 66).

113 In those circumstances, the Commission, which has properly found that a State measure constitutes State aid which, in the light of the derogations provided for by the Treaty, is incompatible with the common market, cannot be required to contemplate that aid's being amended instead of withdrawn.

114 It follows that, by requiring the repeal rather than the amendment of Paragraph 52(8) of the EStG, the Commission has not infringed its obligation to state reasons.

115 Since the fifth part of the first plea cannot be accepted either, the plea must be dismissed as unfounded.

116 Since none of the pleas put forward by the German Government is well founded, the application must in consequence be dismissed.

Decision on costs

Costs

117 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs, if they have been applied for. Since the Commission has applied for costs and the Federal Republic of Germany has been unsuccessful, the latter must be ordered to pay the costs.

Operative part

On those grounds,

THE COURT

hereby:

1. Dismisses the application;

2. Orders the Federal Republic of Germany to pay the costs.