Arrêt de la Cour
Case C-334/02

Commission of the European Communities

v

French Republic

(Failure of a Member State to fulfil obligations – Freedom to provide services – Free movement of capital – Tax on income arising from investments – Debtor not resident or established in France – Exclusion of the fixed levy as the rate – National legislation contrary to the terms of the Treaty)

Summary of the Judgment

Freedom to provide services – Free movement of capital – Restrictions – Tax legislation – Fixed levy on certain income arising from investments – Condition of residence or establishment of the debtor in the Member State concerned – Not permissible – Justification – Absence

(Arts 49 EC and 56 EC)

A Member State has failed to fulfil its obligations under Articles 49 and 59 EC where it excludes altogether the application of the rate of the fixed levy to income arising from certain investments where the debtor is not resident or established in that Member State.

Apart from having the effect of discouraging taxpayers who are resident in a Member State from entering into contracts generating such income with companies which are established in another Member State, such legislation also has a restrictive effect as regards those companies as it prevents them from raising capital in the Member State concerned.

The need to ensure payment of taxes and effective fiscal supervision does not justify such a restriction on the freedom to provide services and the free movement of capital. While the prevention of tax avoidance and the need for effective fiscal supervision may be relied upon to justify restrictions on the exercise of fundamental freedoms guaranteed by the Treaty, a general presumption of tax avoidance or fraud is not, however, sufficient to justify a fiscal measure which compromises the objectives of the Treaty.

Furthermore, the restrictive measure in question does not comply with the principal of proportionality, in that it is not appropriate for securing the attainment of the objective it pursues and it goes beyond what is necessary to attain it.

(see paras 23-24, 27-28, 34, operative part)

JUDGMENT OF THE COURT (Fifth Chamber)
4 March 2004(1)

(Failure of a Member State to fulfil its obligations – Freedom to provide services – Free movement of capital – Tax on income arising from investments – Debtor not resident or established in France

– Exclusion of the fixed levy as the rate – National legislation contrary to the terms of the Treaty)

In Case C-334/02,
Commission of the European Communities, represented by R. Lyal and C. Giolito, acting as Agents, with an address for service in Luxembourg,

applicant,

v

French Republic, represented by G. de Bergues and P. Boussaroque, acting as Agents,

defendant,

APPLICATION for a declaration that by excluding altogether application of the rate of the fixed levy to income arising from the investments and contracts referred to in Articles 125-0 A and 125 A of the Code général des impôts where the debtor is not resident or established in France, the French Republic has failed to fulfil its obligations under Articles 49 and 56 EC,

THE COURT (Fifth Chamber),,

composed of: P. Jann (Rapporteur), acting for the President of the Fifth Chamber, C.W.A. Timmermans and S. von Bahr, Judges,
Advocate General: D. Ruiz-Jarabo Colomer,
Registrar: M. Múgica Arzamendi, Principal Administrator,
after hearing the oral observations of the parties at the hearing on 10 September 2003,
after hearing the Opinion of the Advocate General at the sitting on 16 October 2003,

gives the following

Judgment

1 By application lodged at the Court Registry on 20 September 2002, the Commission of the European Communities brought an action under Article 226 EC, seeking a declaration that by excluding altogether application of the fixed levy to income arising from the investments and contracts referred to in Articles 125-0 A and 125 A of the Code général des impôts (General Tax Code) where the debtor is not resident or established in France, the French Republic has failed to fulfil its obligations under Articles 49 and 56 EC.

Legal framework
2 Article 125 A of the Code général des impôts (hereinafter the 'CGI') in France provides that:
'I. Subject to the provisions of Article 119a(1) and Article 125 B, natural persons who receive interest, accumulated interest and any kind of proceeds from Government securities, bonds, equities, bills and other debt instruments, deposits, indemnity bonds and current accounts, where the debtor is resident or established in France, may elect for them to be subject to a levy in discharge of income tax on the income concerned.
In the event that deduction at source is applied to such income, it will be imputed to the levy in discharge [fixed levy].

The levy is to be deducted by the debtor or the person responsible for payment of the income. …'
3 Article 125 A III a of the CGI specifies the rate of the levy, which varies between 15% and 60%, depending on the nature of the proceeds in question.
4 Article 125-0 A of the CGI states that:
'I. Proceeds arising from bills or investment contracts and other similar investments shall be subject to income tax at the time the contract is concluded.
…
II. The provisions of Article 125A, under exception of paragraph IV of that article, shall apply to the proceeds referred to at I above. …'
5 Under Article 125-0 A II of the CGI, the rate of the levy on these proceeds, save in cases of exemption, varies between 7.5% and 60%, depending on the length of the contract.

Pre-litigation procedure
6 By letter of formal notice of 30 October 2000, the Commission informed the French Government that it considered that the legislation in question might infringe the provisions of the EC Treaty on the freedom to provide services and the free movement of capital. The Commission accordingly invited the French Government to provide the Commission with its observations within a period of two months.
7 The French Government replied by letter received by the Commission on 3 January 2001, stating that it was of the opinion that the legislation in question was lawful. It also stated that it would be in favour of changing its legislation relating to the fixed levy, but reserved the right, however, to require that a tax representative be appointed, particularly in cases of life assurance contracts.
8 As the Commission was not satisfied by these arguments, it sent a reasoned opinion to the French Government on 26 July 2001, calling on it to comply with that opinion within a period of two months.
9 As the French Government failed to respond to the reasoned opinion, the Commission decided to bring these proceedings.

Substance
Pleas in law and arguments of the parties
10 The Commission argues that the fact that the right to elect for the fixed levy under Article 125 A of the CGI is only available where the party paying the income is resident or established in France discriminates against the services offered by financial and life assurance institutions established outside France.
11 The rate of the fixed levy is generally lower than the marginal rate of tax resulting from the application of the progressive rate of tax on income and of splitting income. The fact that this advantage is not available to providers of services established outside France may discourage the recipients of these services from contracting with those service providers, which constitutes a restriction on the freedom to provide services.
12 The legislation in question also prejudices the free movement of capital, in that the investments in question, made by French residents, in foreign securities or undertakings, may never benefit from the more favourable rate, equivalent to the rate of the levy applying to the same income received from a debtor who is resident or established in France.
13 The French Government takes the view that the application is not well founded and should be dismissed. It states, first, that the different tax treatment should be seen in context, as in many cases French residents who have subscribed for investments or entered into contracts, whether in France or abroad, enjoy an identical fiscal regime.
14 In the same way, the difference between the rate at which the levy is applied and the rate of tax on income should be seen in context. First, the average rate applying to taxpayers is 9%, and in the great majority of cases the rate is therefore equal to or less than 15%. Secondly, the average marginal rate is approximately 25%.

15 On the other hand, the particularly low rate of the fixed levy of 7.5% only applies to life assurance contracts having a duration in excess of eight years. For contracts of a shorter duration, the applicable rates are 15% and 35%, which are therefore closer to the average marginal rate of tax on income.
16 The fixed levy also has the disadvantage of being deducted at source, that is to say, payable immediately. On the other hand, income tax only requires to be paid in the month of September in the year following the year in which the income was received. This means that the period for payment could extend to 20 months, which is more favourable.
17 Relying principally on the judgment in Case C-204/90 *Bachmann* [1992] ECR I-249, the French Government argues that even though the fixed levy may, in certain cases, be seen as a fiscal benefit, it is justified by considerations of public interest, based on the need to ensure the payment of taxes and effective fiscal supervision.
18 In the case of the current provisions relating to the fixed levy, it is a straightforward matter for the authorities to exercise fiscal supervision over resident debtors or institutions making payment on their behalf who are, by virtue of the decision of investors to elect for this system, directly liable to pay the tax and subject to supervision in place of the investors. However, where the person liable to make payment is established outside France, the tax authorities would be unable to enforce compliance effectively with the conditions governing the application to the proceeds of the contract of a levy at a rate that may be more favourable than that of the fixed levy. This applies in particular to the conditions relating to the types of contract entered into and the period during which savings cannot be withdrawn. This difficulty is particularly acute when a company is established in a country which practises banking secrecy or which has legislation restricting the scope of the procedures which exist for the exchange of information.
19 It would in theory be possible for the fiscal authorities to supervise the investors themselves, rather than the debtors. However, it would be difficult to cross-check information provided by the former, and such an arrangement would involve abandoning a straightforward and effective system based on global controls *ex ante,* put into place before the levy is collected at source and not open to fraud, in favour of a system of supervision exercised *ex post* and which could not be consistently applied, which would be exposed to risk and which would involve disproportionate expense for the fiscal authorities and for the taxpayers having regard to the measures required for assessing and recovering the tax. Nor do other solutions exist that would achieve the desired result, which is administrative effectiveness and equal treatment of taxpayers.
20 The French Government therefore considers that, should a restriction on the freedom to provide services and the free movement of capital exist, that restriction is justified and respects the principle of proportionality.
Assessment by the Court
21 It should be noted at the outset that although direct taxation falls within the competence of the Member States, they must exercise that competence consistently with Community law and therefore avoid any overt or covert discrimination by reason of nationality (see, inter alia, Case C-385/00 *de Groot* [2002] ECR I-11819, paragraph 75, and Case C-209/01 *Schilling and Fleck-Schilling* [2003] ECR I-0000, paragraph 21).
22 It is not disputed in the present case that the fixed levy may, in certain cases, offer a significant fiscal advantage over the normal system for taxing income. That advantage is not affected by the fact that, in other cases, the advantage to the taxpayer is relatively minor, or offset by the fact that the levy is deducted at source, whereas income tax will normally be payable at a later date. Furthermore, the fixed levy only operates when the taxpayer himself so elects, an option which he will only generally exercise where it is to his advantage.
23 As the application of the fixed levy is restricted under Article 125 A I of the CGI to investment or life assurance contracts where the debtor is resident or established in France, it has the effect of discouraging taxpayers who are resident in France from entering into contracts of this type with companies which are established in another Member State.

Article 49 EC precludes the application of any national legislation which has the effect of making the provision of services between Member States more difficult than the provision of services exclusively within one Member State (see, inter alia, Case C-118/96 *Safir* [1998] ECR I?1897, paragraph 23).

24 The legislation in question also has a restrictive effect as regards companies established in other Member States as it prevents them from raising capital in France, given that the proceeds of contracts taken out with those companies are treated less favourably from a tax point of view than proceeds payable by a company which is established in France. This means that their contracts are less attractive to investors residing in France than those of companies which are established in that Member State (for a similar situation, see Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 35, and Case C-478/98 *Commission* v *Belgium* [2000] ECR I-7587, paragraph 18).

25 In those circumstances, it should be held that the rule in question constitutes a restriction both on the freedom to provide services under Article 49 EC, and on the free movement of capital under Article 56 EC.

26 It is accordingly necessary to establish whether these restrictions are justified on the grounds put forward by the French Government.

27 The latter relies on the need to ensure payment of taxes and effective fiscal supervision. It is true that the Court has repeatedly held that the prevention of tax avoidance and the need for effective fiscal supervision may be relied upon to justify restrictions on the exercise of fundamental freedoms guaranteed by the Treaty (see Case C-254/97 *Baxter and Others* [1999] ECR I?4809, paragraph 18, and *Commission* v *Belgium*, cited above, paragraph 39). However, a general presumption of tax avoidance or fraud is not sufficient to justify a fiscal measure which compromises the objectives of the Treaty (see, to that effect, the judgment in *Commission* v *Belgium*, cited above, paragraph 45).

28 Furthermore, for a restrictive measure to be justified, it must comply with the principle of proportionality, in that it must be appropriate for securing the attainment of the objective it pursues and must not go beyond what is necessary to attain it (*Commission* v *Belgium*, cited above, paragraph 41). Compliance with that principle is especially important where national legislation excludes cross-border transactions from national rules altogether.

29 In the present case, deduction at source, operated directly by debtors resident in France, will admittedly be a straightforward process for the tax authorities. Where debtors are resident in other Member States, it may prove more difficult to ascertain whether all the conditions necessary for the application of a particular rate of levy have been met. However, that involves disadvantages of a purely administrative nature which are not, as the Advocate General has noted at points 29 and 30 of his Opinion, sufficient to justify a restriction on the freedom to provide services and on the free movement of capital of the type which the legislation in question gives rise to.

30 As regards less restrictive solutions that may be available, the French Government has itself recognised that the practical difficulties could be avoided by, for example, providing for a voluntary annual declaration of income received from companies established in other Member States to be included in tax returns, for the purpose of the operation of the fixed levy. A solution of that kind would fully resolve issues of supervision and, for the reasons given at point 31 of the Advocate General's Opinion, it would not affect the stability of the tax system in question.

31 As regards effective fiscal supervision, the Commission has rightly referred to Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336, p. 15), which can be invoked by a Member State in order to check whether payments have been made in another Member State, or to obtain all necessary information, where those payments and that information must be taken into account in determining the correct amount of income taxes (see *Bachmann*, cited above, paragraph 18, and Case C?55/98 *Vestergaard* [1999] ECR I-7641, paragraphs 26 and 28). Member States are free to resort to these arrangements when it appears appropriate to them to do so.

32 The French Government's argument that this directive does not have effect in Member States which practise banking secrecy has already been rejected by the Court in its judgment in Case C?300/90 *Commission* v *Belgium* [1992] ECR I-305, paragraph 13. Accordingly, the impossibility of requesting cooperation of that kind does not justify the failure to make a tax advantage available to income received from those States.
33 Lastly, as regards the obstacles which the French Government claims exist in relation to the opportunities which Directive 77/799 provides, reference should be made to the analysis of these arguments and their rebuttal which are set out at points 34 to 36 of the Advocate General's Opinion.
34 The French Government has therefore failed to justify the measure in question. The Commission's application should accordingly be granted, and it should be held that by excluding altogether application of the rate of the fixed levy to income arising from the investments and contracts referred to in Articles 125-0 A and 125 A of the Code général des impôts where the debtor is not resident or established in France, the French Republic has failed to fulfil its obligations under Articles 49 and 56 EC.

Costs
35 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs, if they have been applied for in the successful party's pleadings. Since the Commission has applied for costs and the French Republic has been unsuccessful, the latter must be ordered to pay the costs.
On those grounds,

THE COURT (Fifth Chamber)

hereby:
1.Declares that by excluding altogether application of the rate of the fixed levy to income arising from the investments and contracts referred to in Articles 125-0 A and 125 A of the Code général des impôts where the debtor is not resident or established in France, the French Republic has failed to fulfil its obligations under Articles 49 and 56 EC;
2.Orders the French Republic to pay the costs.
Jann

Timmermans

von Bahr

Delivered in open court in Luxembourg on 4 March 2004.
R. Grass

V. Skouris

Registrar

President

1 – Language of the case: French.