Case C-562/07

Commission of the European Communities

v

Kingdom of Spain

(Failure of a Member State to fulfil obligations ? Free movement of capital ? Article 56 EC and Article 40 of the EEA Agreement ? Direct taxation ? Natural persons ? Taxation of capital gains ? Difference in treatment of residents and non?residents)

Summary of the Judgment

1. *Member States – Obligations – Failure to fulfil obligations – Justification – Principle of the protection of legitimate expectations – Duty of cooperation in good faith*

(Art. 226 EC)

2. *Actions for failure to fulfil obligations – Pre-litigation procedure – Excessive duration*

(Art. 226 EC)

3. *Actions for failure to fulfil obligations – Examination of the merits by the Court – Situation to be taken into consideration – Situation on expiry of the period laid down in the reasoned opinion*

(Art. 226 EC)

4. *Actions for failure to fulfil obligations – Period given the Member State in the reasoned opinion – Default subsequently remedied – Interest in continuing the proceedings*

(Art. 226 EC)

5. *Actions for failure to fulfil obligations – Right of the Commission to bring judicial proceedings*

(Art. 226 EC)

6. *Free movement of capital – Restrictions – Tax legislation – Income tax*

(Arts 56 EC and 58(1); EEA Agreement, Art. 40)

1. The procedure for a declaration of failure to fulfil obligations is based on the objective finding that a Member State has failed to fulfil its obligations under Community law. The principles of protection of legitimate expectations and cooperation in good faith cannot be relied on by a Member State in order to preclude an objective finding of a failure on its part to fulfil its obligations under the EC Treaty, since to admit that justification runs counter to the aim pursued by the procedure under Article 226 EC. The fact that the Commission may have decided not to bring an action seeking a declaration that a Member State has failed to fulfil obligations when that Member State had put an end to the alleged failure after the expiry of the time prescribed in the reasoned opinion cannot, therefore, cause either that Member State or other Member States to have a legitimate expectation which may affect the admissibility of an action brought by the Commission. Further, the fact that the Commission does not bring an action under Article 226 EC immediately

after the expiry of the time prescribed in the reasoned opinion can also not cause the Member State concerned to have a legitimate expectation that the infringement proceedings have been closed.

(see paras 18-20)

2. Admittedly, the excessive duration of the pre-litigation procedure is capable of constituting a defect rendering an action for failure to fulfil obligations inadmissible. However, such a conclusion is inevitable only where the conduct of the Commission has made it difficult to refute its arguments, thus infringing the rights of defence of the Member State concerned, and it is for that Member State to provide evidence of such a difficulty.

(see para. 21)

3. In an action under Article 226 EC, the question whether there has been a failure to fulfil obligations must be examined on the basis of the position in which the Member State found itself at the end of the period specified in the reasoned opinion.

(see para. 23)

4. The Commission still has an interest in bringing an action under Article 226 EC even when the alleged infringement has been remedied after the expiry of the period prescribed in the reasoned opinion. It follows that, where a Member State was informed through the pre?litigation procedure that the Commission alleged that it had failed to fulfil its obligations under the Treaty, the Member State cannot, in the absence of any explicit statement of position by the Commission indicating that it was going to close the ongoing infringement proceedings, validly contend that the Commission has infringed the principle of legal certainty.

(see paras 23-24)

5. The Commission does not have to show an interest to bring proceedings or to state the reasons why it is bringing an action for failure to fulfil obligations. Since the subject-matter of the action as it is to be found in the application corresponds to the subject?matter of the dispute as stated in the letter of formal notice and in the reasoned opinion, it cannot validly be maintained that the Commission has misused its powers.

(see para. 25)

6. Where a Member State taxes differently capital gains realised in that Member State according to whether they were made by residents or by non?residents, although those taxpayers are in an objectively comparable situation with regard to that taxation, that Member State has failed to fulfil its obligations under Article 56 EC and Article 40 of the Agreement on the European Economic Area.

Legislation which targets only capital gains accruing on the disposal of assets owned in the Member State concerned, which does not pursue, by means of granting an advantageous tax treatment to residents, a social purpose and which is not demonstrated to be intended to take account of the personal situation of the taxpayer in respect of payment of the tax, does not correspond to any difference in situation, for the purposes of Article 58(1) EC, based on the taxpayers' place of residence.

The existence of double taxation agreements cannot affect that conclusion where such agreements cancel out only in part the tax liability of non?residents in the Member State concerned. Further, the existence of a double taxation agreement does not mean that the income

which a taxpayer receives in a State where he is not resident and which is exclusively liable to tax in that State may not nevertheless be taken into consideration by the State of residence when calculating the amount of the tax on the remaining income of that taxpayer in order, in particular, to reflect the principle that taxes should be applied progressively. The fact that a taxpayer is non?resident does not enable him to escape the application of that rule. It follows that, in such circumstances, the two categories of taxpayers are in a comparable situation with regard to that rule.

The restriction stemming from such legislation cannot be justified by the need to safeguard the cohesion of the national tax system where there is no direct link between the advantages granted to resident taxpayers and any offsetting as a result of a particular tax levy.

(see paras 50-59, 65-66, 69, operative part)

JUDGMENT OF THE COURT (First Chamber)

6 October 2009 (*)

(Failure of a Member State to fulfil obligations ? Free movement of capital ? Article 56 EC and Article 40 of the EEA Agreement ? Direct taxation ? Natural persons ? Taxation of capital gains ? Difference in treatment of residents and non?residents)

In Case C?562/07,

ACTION under Article 226 EC for failure to fulfil obligations, brought on 19 December 2007,

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

applicant,

v

Kingdom of Spain, represented by M. Muñoz Pérez, acting as Agent, with an address for service in Luxembourg,

defendant,

supported by:

Kingdom of Belgium, represented by T. Materne, acting as Agent,

Republic of Latvia, represented by E. Balode-Buraka, acting as Agent,

Republic of Austria, represented by E. Riedl and C. Pesendorfer, acting as Agents,

interveners,

THE COURT (First Chamber),

composed of M. Ileši?, President of the Fifth Chamber, acting as President of the First Chamber, A. Tizzano, A. Borg Barthet, E. Levits and J.-J. Kasel (Rapporteur), Judges,

Advocate General: J. Kokott,

Registrar: R. Grass,

having regard to the written procedure,

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

gives the following

Judgment

1 By its application, the Commission of the European Communities asks the Court to declare that, by having treated differently, until 31 December 2006, capital gains realised in Spain according to whether they were made by residents or by non-residents, the Kingdom of Spain failed to fulfil its obligations under Articles 39 EC and 56 EC and Articles 28 and 40 of the Agreement on the European Economic Area of 2 May 1992 (OJ 1994 L 1, p. 3, 'the EEA Agreement').

Legal context

2 In Spain, the taxation of residents' income was, until 31 December 2006, governed by the consolidated law on the tax on the income of natural persons (Texto Refundido de la Ley del Impuesto sobre la Renta de las Personas Físicas), adopted by Royal Legislative Decree No 3/2004 of 5 March 2004 (BOE No 60 of 10 March 2004, p. 10670, and corrigendum, BOE No 61 of 11 March 2004, p. 11014, 'the TRLIRPF'). Pursuant to Articles 67 and 77 of the TRLIRPF, capital gains accruing on the disposal by the taxpayer of assets owned for more than one year were taxed at a flat rate of 15%. Other capital gains were taxed according to a progressive scale laid down in Articles 64 and 75 of the TRLIRPF, the rates of which ranged from 15% to 45%.

3 Until the same date, the taxation of non-residents' income was governed by the consolidated law on the tax on the income of non?residents (Texto Refundido de la Ley del Impuesto sobre la Renta de no Residentes), adopted by Royal Legislative Decree No 5/2004 of 5 March 2004 (BOE No 62 of 12 March 2004, p. 11176, 'the TRLIRNR'), Article 25(1)(f) of which subjected capital gains to a flat rate of tax of 35%.

4 Under Article 46 of the TRLIRNR, non-residents at least 75% of whose total income came, in a single tax year, from employment or economic activity in Spain were able to choose to be taxed as persons liable to the tax on the income of natural persons. Article 46(3) provided that the personal and family circumstances of those workers were to be taken into consideration.

5 That system was repealed as from 1 January 2007 with the entry into force of Law No 35/2006 on the taxation of income of natural persons and partially amending the laws on corporation tax, taxation on the income of non-residents and taxation on wealth (Ley 35/2006 del Impuesto sobre la Renta de las Personas Físicas y de modificación parcial de las leyes de los Impuestos sobre Sociedades, sobre la Renta de no Residentes y sobre el Patrimonio, BOE No 285 of 29 November 2006, p. 41734, and corrigendum, BOE No 57 of 7 March 2007, p. 9634).

The pre-litigation procedure

6 On 18 October 2004 the Commission sent a letter of formal notice to the Kingdom of Spain, drawing the attention of that Member State to the fact that the way in which natural persons who were not resident in Spain were treated as regards the taxation to which their employment income and their capital gains arising in Spain were at that time subject was, in the Commission's opinion, contrary to Articles 39 EC and 56 EC and to Articles 28 and 40 of the EEA Agreement, since the application to non-residents' income of taxation at a higher rate than that applicable to residents' income could constitute discrimination for the purpose of the EC Treaty if there was no objective difference capable of justifying a difference in treatment of the two situations.

7 Since the reply of the Kingdom of Spain did not satisfy the Commission, on 13 July 2005 the Commission sent a reasoned opinion to that Member State, calling upon it to adopt the measures necessary to achieve compliance within two months of receipt.

8 On 7 February 2006, the Kingdom of Spain replied to that reasoned opinion stating that the amendments necessary to put an end to the alleged failures to fulfil obligations were being adopted. It appears from the observations of the parties that those amendments were adopted on 28 November 2006 and entered into force on 1 January 2007.

9 Although the Commission considers that, with the entry into force of the new provisions, the infringements which it complained of were brought to an end, the Commission decided to bring the present action.

10 In the course of the proceedings before the Court, the Commission withdrew its action in so far as seeking a declaration of an infringement of Article 39 EC and Article 28 of the EEA Agreement.

11 By order of the President of the Court of 2 June 2008, the Kingdom of Belgium, the Republic of Latvia and the Republic of Austria were given leave to intervene in support of the forms of order sought by the Kingdom of Spain.

The action

Admissibility

Arguments of the parties

12 The Kingdom of Spain, which acknowledges that it is for the Commission to decide whether or not it is appropriate to initiate an action for failure to fulfil obligations, none the less calls into question the admissibility of this action, claiming that the Commission has, in the present case, infringed the principles of the protection of legitimate expectations, cooperation in good faith with Member States and legal certainty, and has misused its powers.

13 As regards, first, the infringement of the principles of the protection of legitimate expectations and cooperation in good faith, the Kingdom of Spain states that Member States may rely on those principles against a Community institution where that institution, by a repeated and uninterrupted practice, has caused them to have a justified expectation that the institution would follow a specific line of conduct in specific circumstances, and there is nothing to suggest that the institution will alter that practice. In relation to infringement proceedings, the Commission has a well?established practice which consists of not initiating such an action where the Member State which has infringed Community law has put an end to the failure after the expiry of the period prescribed in the reasoned opinion, but before the bringing of the action, even when the

proceedings may still be relevant. In the present case, the Commission infringed the abovementioned principles because it brought its action almost a year after the failure complained of had been brought to an end, and did not either first inform the Member State concerned of its intention to depart from its usual practice or have any valid grounds for doing so.

14 As regards, secondly, the principle of legal certainty, the Kingdom of Spain claims that the right which the Commission is acknowledged to have freely to choose when to initiate infringement proceedings against a Member State should, in order not to put Member States into a 'serious situation of legal uncertainty', be restricted to cases where the offending Member State persists in the failure complained of. Since the Commission, in the present case, allowed almost a year to elapse from the time when the alleged failure was brought to an end and the bringing of this action, the principle of legal certainty has been infringed.

15 As regards, thirdly, misuse of powers, the Kingdom of Spain claims that the Commission is distorting the purpose of infringement proceedings since it is using such proceedings to achieve two objectives which are extraneous to that purpose. First, the Commission's intention is to punish the Kingdom of Spain because the Spanish courts and tribunals have not submitted references for a preliminary ruling to the Court of Justice on the subject of direct taxation. Secondly, the Commission wants to obtain a ruling from the Court on this action in order to ensure that citizens have the benefit of correctly applied Community law, and thereby assimilates the purpose of infringement proceedings to that of the preliminary rulings procedure.

16 The Kingdom of Belgium and the Republic of Austria, whose interventions in support of the forms of order sought by the Kingdom of Spain are limited to the question of the action's admissibility, claim that it is the task of the Commission to establish the existence of sufficient interest to continue proceedings. In the present case, the seriousness of the alleged failure is not such as to justify the bringing of an action, since the fact that the Spanish courts and tribunals have not submitted references for a preliminary ruling on the subject of direct taxation does not demonstrate sufficient interest to bring the present action. Furthermore, the Commission can bring infringement proceedings only with the specific aim of putting an end to the alleged failure to fulfil obligations. Since the Kingdom of Spain has put an end to the failure complained of, the Commission is no longer free to assess whether it is appropriate to bring an action.

17 As regards the admissibility of infringement proceedings in general, the Commission contends, principally, that the discretion which the Treaty and the Court's case-law accord to it in relation to infringement proceedings means, first, that it can decide whether or not it is appropriate to bring an action and that it does not have to state the reasons for its decision and, secondly, that it is not bound to comply with any specific time-limit as regards the various stages of proceedings. Therefore, in its opinion, none of the grounds of inadmissibility put forward by the Kingdom of Spain can succeed.

Findings of the Court

18 As regards, first, the alleged infringement of the principle of protection of legitimate expectations, a corollary of the principle of legal certainty, and the principle of cooperation in good faith, it must be recalled that the procedure for a declaration of failure on the part of a Member State to fulfil its obligations is based on the objective finding that a Member State has failed to fulfil its obligations under Community law and that the principles of protection of legitimate expectations and loyal cooperation cannot, in circumstances such as those of the present case, be relied on by a Member State in order to preclude an objective finding of a failure on its part to fulfil its obligations under the EC Treaty, since to admit that justification would run counter to the aim pursued by the procedure under Article 226 EC (Case C?523/04 *Commission* v *Netherlands* [2007] ECR I?3267, paragraph 28).

19 The fact that the Commission may, where appropriate, have decided not to bring an action seeking a declaration that a Member State has failed to fulfil obligations where that Member State had put an end to the alleged failure after the expiry of the time prescribed in the reasoned opinion cannot therefore cause either that Member State or other Member States to have a legitimate expectation which may affect the admissibility of an action brought by the Commission.

20 Nor, it must be added, can the fact that the Commission does not bring an action under Article 226 EC immediately after the expiry of the time prescribed in the reasoned opinion cause the Member State concerned to have a legitimate expectation that the infringement proceedings have been closed.

21 Admittedly, the excessive duration of the pre-litigation procedure is capable of constituting a defect rendering an action for failure to fulfil obligations inadmissible. However, it is clear from the case-law that such a conclusion is inevitable only where the conduct of the Commission has made it difficult to refute its arguments, thus infringing the rights of defence of the Member State concerned, and that it is for that Member State to provide evidence of such a difficulty (see, to that effect, Case C?33/04 *Commission* v *Luxembourg* [2005] ECR I?10629, paragraph 76 and case-law there cited).

22 It is however clear that, in the present case, the Kingdom of Spain has not put forward any specific argument in support of the fact that the length of the pre?litigation procedure and, in particular, the period of time which elapsed between its response to the reasoned opinion and the bringing of this action, affected the exercise of its rights of defence. The Kingdom of Spain does no more than dispute the appropriateness, in the present case, of the Commission exercising its right to initiate and continue infringement proceedings.

23 As regards, secondly, the principle of legal certainty, it must be pointed out that the Court has consistently held that, first, the question whether there has been a failure to fulfil obligations must be examined on the basis of the position in which the Member State found itself at the end of the period laid down in the reasoned opinion (see, inter alia, Case C?173/01 *Commission* v *Greece* [2002] ECR I?6129, paragraph 7, and Case C?519/03 *Commission* v *Luxembourg* [2005] ECR I?3067, paragraph 18) and, secondly, the Commission still has an interest in bringing an action under Article 226 EC even when the alleged infringement has been remedied after the expiry of the period prescribed in the reasoned opinion (Case C?519/03 *Commission* v *Luxembourg*, paragraph 19).

24 It follows that, since the Kingdom of Spain was informed through the pre?litigation procedure that the Commission alleged that it had failed to fulfil its obligations under the Treaty, it cannot, in the absence of any explicit statement of position by the Commission indicating that it was going to close the ongoing infringement proceedings, validly contend that the Commission has infringed the principle of legal certainty.

25 As regards, thirdly, the plea in law based on an alleged misuse of powers, suffice it to state that, in accordance with the Court's settled case-law, the Commission does not have to show an interest to bring proceedings or to state the reasons why it is bringing an action for failure to fulfil obligations (see, inter alia, Case C?333/99 *Commission* v *France* [2001] ECR I?1025, paragraph 24; Case C?474/99 *Commission* v *Spain* [2002] ECR I?5293, paragraph 25; and Case C?33/04 *Commission* v *Luxembourg*, paragraphs 65 and 66). Since the subject-matter of the action as it is to be found in the application corresponds to the subject?matter of the dispute as stated in the letter of formal notice and in the reasoned opinion, it cannot validly be maintained that the Commission has misused its powers.

26 It follows from the foregoing considerations that the present action must be declared admissible.

Substance

Arguments of the parties

27 The Commission states that, under the Spanish legislation applicable until 31 December 2006, capital gains realised in Spain by non-resident taxpayers upon a disposal of assets were taxed at a flat rate of 35%, whereas those realised by residents were taxed according to a progressive scale where the assets disposed of had been owned for one year or less and at a flat rate of 15% where those assets had been owned for more than one year. Consequently, the tax liability borne by non?residents was always greater when they disposed of their assets one year or more after the acquisition of those assets. As regards the disposal of an asset owned for one year or less, non-residents were again subject to a higher tax liability, except when the average tax rate applied to resident taxpayers reached or exceeded 35%, which was the case when income was very substantial.

28 According to the Commission, since, in the present case, there is no objective difference between resident taxpayers and non?resident taxpayers, any difference in treatment manifesting itself in a higher tax liability for non-residents as compared with residents constitutes discrimination for the purposes of the Treaty.

29 As regards the justifications put forward by the Kingdom of Spain, the Commission claims that, in the present case, pursuit of an objective of tax cohesion cannot validly be relied upon. In accordance with the Court's case?law, that justification can be accepted only when there is a direct link between the granting of a tax advantage and the offsetting of that advantage by a fiscal charge. In the present case, the higher tax liability borne by non?residents was not accompanied by their enjoyment of any tax advantage.

30 The Commission adds that it considers that the reasoning adopted by the Court in Case C?107/94 *Asscher* [1996] ECR I?3089 can be applied to the present case, since the Spanish tax provisions at issue in the present action, like the provisions of national law at issue in *Asscher*, provide for the application to capital gains realised by non-residents of taxation at a higher rate than that applicable to capital gains made by residents. Having regard to the Court's case-law, the fact that *Asscher* relates to freedom of establishment does not preclude the outcome of that case

being applied to the Spanish provisions at issue in the present case.

31 The Kingdom of Spain, which does not accept that there was the failure alleged, states, first, that the capital gain which a non-resident realises upon selling an asset which he owns in Spain constitutes only a part of his income, the latter generally consisting mainly of income derived from his occupation. In addition, in order to determine whether resident taxpayers and non?resident taxpayers are in an objectively comparable situation, it is necessary to take an overall view of the activities of those taxpayers and the income which they derive from them, and not to examine only one single type of transaction.

32 The place where the individual ability of a non-resident to pay tax can most easily be assessed is the place where his personal and property interests are centred. As a general rule, that coincides with the place where he is habitually resident. Where there are exceptions, the Kingdom of Spain states that taxpayers who do not reside in Spain, but who have obtained there, from their employment and their other economic activities, income constituting at least 75% of their total income, may, under the system provided for in Article 46 of the TRLIRNR, and for as long as it is established that they have their domicile or habitual residence in another Member State, choose to have their income taxed according to the rules applicable to residents. The Spanish legislation thus complies with the Court's case-law, the Kingdom of Spain referring in that regard to Case C?234/01 *Gerritse* [2003] ECR I?5933.

33 In any event, since the situation of resident taxpayers and non?resident taxpayers is not comparable in relation to the taxation of capital gains, the fact that there is not one identical body of rules which applies to both those categories of taxpayers does not constitute discrimination. Consequently, in the present case, there is no failure to observe the principle of free movement of capital.

34 Next, the Kingdom of Spain states that, in accordance with the Court's case-law, a Member State is free to ensure compliance with its obligations under the Treaty by entering into an agreement to prevent double taxation (a 'double taxation agreement') with another Member State. Since the Kingdom of Spain has entered into a double taxation agreement with almost all Member States, Spanish taxation, the effects of which are in part eliminated, therefore does not constitute a restriction on the free movement of capital.

35 Lastly, the Kingdom of Spain states that in paragraph 43 of Case C?376/03 *D.* [2005] ECR I?5821 the Court held that Articles 56 EC and 58 EC do not preclude national legislation which denies non?resident taxpayers who hold the major part of their wealth in the State where they are resident entitlement to allowances which that legislation grants to resident taxpayers. The Spanish tax legislation at issue in the present case does no more than apply that case-law by introducing, into the tax system, a distinction based on the objectively different situation in which resident taxpayers are placed as compared with non?resident taxpayers.

36 Alternatively, in the event that the legislation at issue is deemed to constitute a restriction on the free movement of capital, the Kingdom of Spain claims that that restriction was justified by the need to safeguard the cohesion of the Spanish tax system.

37 In that regard, the Kingdom of Spain states that, as regards short-term capital gains (one year or less), those realised by non-residents were taxed on a transaction?by?transaction basis, while those realised by residents were taxed according to the progressive scale applicable to income tax, the rates of which ranged from 15% to 45%. It cannot therefore be held that residents were systematically afforded a tax treatment which was more favourable that that afforded to non?residents.

38 In any event, the existence of distinct rates for the tax on residents and the tax on non-residents is justified by the very nature of each of those taxes. The tax on the income of natural persons who are resident is levied periodically and adjusted to the person concerned's ability to pay by means of applying a progressive scale to the worldwide income received by that person during the taxation period.

39 The tax on the income of non-residents is, on the other hand, a tax which is immediately payable by taxpayers who receive income in Spain and have no permanent establishment there. Those taxpayers are taxed only on income which they receive in Spain, income which is, by definition, one-off and sporadic. It is therefore impossible to tax that income according to a progressive scale. The only way of achieving the taxation of that income is to levy a tax on a transaction?by?transaction basis by the application of a flat rate.

40 Under the legislation applicable to natural persons who are resident, capital gains made over the long term (more than one year) were taxed at rates the same as or lower than those at which short-term capital gains (one year or less) were taxed. The objective pursued was to avoid the cumulative effects of a progressive scale on capital gains generated over a number of years, which, rather than being subject to annual taxation as they arise, are taxed when they are realised. There was therefore a direct economic link between the granting of a tax advantage to resident taxpayers – taxation at a reduced rate – and the harm which they would suffer in the absence of that mechanism to eliminate excessive progressivity, or another mechanism with the same effects. However, there is no reason to apply to non?resident taxpayers a more favourable taxation rate in the event that they realise long-term capital gains. In fact, through the application of a flat rate of 15%, they have received a favourable treatment intended to offset the effects of a progressive scale which is not applicable to them.

Findings of the Court

41 First, it must be recalled that Article 56 EC prohibits restrictions on the movement of capital, subject to the provisions of Article 58 EC. It is clear from Article 58(1) and (3) EC that Member States may, in their tax law, distinguish between resident and non-resident taxpayers in so far as the distinction drawn does not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital.

42 It must be added that Article 58(1) EC, which, as a derogation from the fundamental principle of the free movement of capital, must be interpreted strictly, cannot be interpreted as meaning that any tax legislation making a distinction between taxpayers by reference to the place where they invest their capital is automatically compatible with the Treaty (see, to that effect, Case C?315/02 *Lenz* [2004] ECR I?7063, paragraph 26).

43 In the present case, it is common ground that until 31 December 2006 the Spanish legislation provided for a difference in treatment of resident taxpayers and non?resident taxpayers as regards the rate of taxation to which were subject capital gains accruing on the disposal of assets, either fixed assets or other kinds of assets, owned in Spain.

44 As regards capital gains realised further to the disposal of assets owned for more than one year, non-residents were systematically subject to a higher tax liability than that borne by residents, the capital gains realised by the latter being taxed at the flat rate of 15% while those realised by non-residents were taxed at 35%.

45 Admittedly, because of the application to them of the progressive scale, residents were not systematically entitled to a more favourable taxation rate than non?residents in relation to the

taxation of capital gains realised upon the sale of assets owned for one year or less. Nevertheless, given that non-residents were subject to a flat rate of 35% irrespective of the amount of the capital gain realised, whereas residents were subject to that rate only when their overall income reached a certain threshold, non-residents were subject, at least in some circumstances, to a tax liability greater than that borne by residents.

46 As the Court has already held, in relation to direct taxes, the situations of residents and of non-residents within a State are generally not comparable, because the income received in the territory of a Member State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence, and because a non?resident's personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is easier to assess at the place where his personal and financial interests are centred, which in general is the place where he is habitually resident (Case C?279/93 *Schumacker* [1995] ECR I?225, paragraphs 31 and 32, and *Gerritse*, paragraph 43).

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

48 In the present case, it is therefore necessary to examine whether there is an objective difference between the situation of residents and that of non-residents which may allow the discriminatory character of the legislation at issue to be disregarded and may bring that legislation within the exception provided for in Article 58(1) EC.

49 As regards the argument that the difference in tax treatment resulting from the application of that legislation to non-residents must be examined together with the general income tax system applicable to residents and non-residents, and that non-residents cannot be compared to residents, because they have in their State of residence other income which, unlike that of residents, is not taken into account in Spain, it must be observed that, first, at least in respect of the taxation of capital gains accruing on the disposal of assets owned for more than one year, only that type of gain is targeted by the legislation in question, whether the taxpayers are resident or non?resident.

50 Secondly, the State in which the source of the income is situated is in both cases the Kingdom of Spain, since the legislation at issue targets only capital gains accruing on the disposal of assets owned in Spain.

51 As regards the argument that, in relation to capital gains accruing on the disposal of assets owned for more than one year, the purpose of the legislation at issue is to take account of the personal situation of the taxpayer in respect of payment of the tax, suffice it to state that the legislation contains nothing capable of supporting that argument, since it concerns taxation levied at a flat rate which is solely dependent on the status of the taxpayer as resident or non?resident.

52 Nor can that argument be supported by an application of *Gerritse* by way of analogy, as relied on by the Kingdom of Spain. It has neither been demonstrated nor even claimed that the legislation against which the present action is directed, as distinct from that at issue in *Gerritse*, pursued, by means of granting an advantageous tax treatment to residents, a social purpose. It follows that, in contrast to what the Court decided in paragraph 48 of *Gerritse*, it cannot, in the present case, be regarded as legitimate to reserve the grant of that advantageous treatment to persons who receive the greater part of their taxable income in the State of taxation, that is to say, as a general rule, residents.

53 As regards the double taxation agreements on which the Kingdom of Spain relies, it must be observed, first, that the Kingdom of Spain has not claimed to have entered into any double taxation agreement with the States which are parties to the EEA Agreement. Next, as the Kingdom of Spain itself acknowledges, a double taxation agreement has not been entered into with all other Member States. Lastly, it is common ground that the double taxation agreements that are in place cancel out only in part the tax liability of non-residents in Spain.

54 It is clear moreover from the Court's case-law that the existence of a double taxation agreement does not mean that the income which a taxpayer receives in a State where he is not resident and which is exclusively liable to tax in that State may not nevertheless be taken into consideration by the State of residence when calculating the amount of the tax on the remaining income of that taxpayer in order, in particular, to reflect the principle that taxes should be applied progressively. It cannot therefore be validly argued that the fact that a taxpayer is non-resident enables him to escape the application of that rule. It follows that, in such circumstances, the two categories of taxpayers are in a comparable situation with regard to that rule (see, to that effect, *Asscher*, paragraphs 47 and 48).

55 In those circumstances, it must be concluded that, in relation to the taxation of capital gains accruing on the disposal of assets owned for more than one year, the legislation at issue does not correspond to any difference in situation, for the purposes of Article 58(1) EC, based on the taxpayers' place of residence (see, to that effect, *Lenz*, paragraph 33).

56 The same conclusion must be drawn as regards the taxation of capital gains realised after no more than one year.

57 First, the considerations adopted in paragraphs 58 and 60 to 62 of this judgment apply equally to taxation of that kind.

58 Secondly, while the possibility cannot be ruled out that taxation according to a progressive scale is capable of taking account of taxpayers' ability to pay, the Kingdom of Spain has not advanced any evidence sufficient to establish that, in the present case, account is actually taken of the personal situation of resident taxpayers in relation to the taxation of capital gains accruing on the disposal of assets owned for one year or less.

59 It follows that the Kingdom of Spain's argument, both in respect of short-term and long-term capital gains, that, with regard to the taxation at issue, residents and non-residents are not in an objectively comparable situation, is unfounded and therefore cannot be accepted.

60 It remains however to be considered whether, as claimed in the alternative by the Kingdom of Spain, that difference in treatment of those two categories of taxpayers may be justified by an overriding reason in the public interest, such as the need to safeguard the cohesion of the tax system.

61 In that regard, it is clear from the case-law of the Court that such an objective may justify a restriction on the exercise of the fundamental freedoms guaranteed by the Treaty. However, for an argument based on such a justification to succeed, a direct link has to be established between the granting of the tax advantage concerned and the offsetting of that advantage by a particular tax levy (Case C?319/02 *Manninen* [2004] ECR I?7477, paragraph 42).

62 According to the Kingdom of Spain, the tax legislation at issue seeks to avoid penalising residents, in the context of the taxation of capital gains, by applying a progressive scale. As regards the taxation of capital gains accruing on the disposal of assets owned for more than one year, there is a direct link, for residents, between the tax advantage resulting from the taxation of those capital gains at the flat rate of 15% and the progressive tax scale applicable to their total income. As regards capital gains realised in one year or less, the advantage of not being subject to a flat rate of 35% is offset by residents being subject to taxation according to a progressive scale on the whole of their worldwide income.

63 As regards the first of those situations, it must be observed that the income to which the flat rate of 15% is applied is not subject to income tax according to a progressive scale. Therefore, it cannot validly be claimed that the granting to residents of the tax advantage at issue, namely the taxation of that income at a flat rate of 15%, is offset by the application of a progressive scale in respect of the taxation of income.

64 As regards the second situation, the advantage, for the resident taxpayer, of not being subject to a flat rate of 35% is admittedly, as a general rule, offset by the disadvantage of having the capital gains concerned added to his total income and thereby subject to taxation according to a progressive scale. However, the possibility cannot be ruled out that, even when taxed in that way, the capital gains realised by residents may be less heavily taxed than those realised by non-residents.

65 In those circumstances, it must be concluded that there is no direct link between the advantages granted to resident taxpayers and any offsetting as a result of a particular tax levy.

66 Consequently, the Court must reject the Kingdom of Spain’s argument that the restriction stemming from the legislation at issue is justified by the need to safeguard the cohesion of the national tax system.

67 Since the provisions of Article 40 of the EEA agreement have the same legal scope as the provisions, identical in substance, of Article 56 EC (see Case C?521/07 *Commission* v *Netherlands* [2009] ECR I?0000, paragraph 33), the foregoing considerations can be applied *mutatismutandis* to Article 40.

68 Having regard to all of the foregoing considerations, the action brought by the Commission must be considered well founded.

69 In those circumstances, it must be declared that, by treating differently, until 31 December 2006, capital gains realised in Spain according to whether they were made by residents or by non-residents, the Kingdom of Spain failed to fulfil its obligations under Article 56 EC and Article 40 of the EEA Agreement.

Costs

70 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 Kingdom of

Spain has been unsuccessful and the Commission has applied for costs, the Kingdom of Spain must be ordered to pay the costs.

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

1. **Declares that, by treating differently, until 31 December 2006, capital gains realised in Spain according to whether they were made by residents or by non-residents, the Kingdom of Spain failed to fulfil its obligations under Article 56 EC and Article 40 of the Agreement on the European Economic Area of 2 May 1992;**

2. **Orders the Kingdom of Spain to pay the costs.**

[Signatures]

* Language of the case: Spanish.