JUDGMENT OF THE COURT (Third Chamber)

16 April 2015 (*)

(Failure of a Member State to fulfil obligations — Tax legislation –Deferral of taxation of capital gains realised on the sale of certain capital assets — Recovery of the tax — Freedom of establishment — Article 49 TFEU — Article 31 of the EEA Agreement — Difference in treatment between permanent establishments located within the territory of a Member State and permanent establishments located within the territory of another Member State of the European Union or of the European Economic Area — Proportionality)

In Case C?591/13,

ACTION for failure to fulfil obligations under Article 258 TFEU, brought on 20 November 2013,

European Commission, represented by W. Mölls and W. Roels, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Federal Republic of Germany, represented by T. Henze and K. Petersen, acting as Agents,

defendant,

THE COURT (Third Chamber),

composed of M. Ileši?, President of the Chamber, A. Ó Caoimh, C. Toader, E. Jaraši?nas and C.G. Fernlund (Rapporteur), Judges,

Advocate General: Y. Bot,

Registrar: K. Malacek, Administrator,

having regard to the written procedure and further to the hearing on 26 November 2014,

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

gives the following

Judgment

1 By its application, the European Commission asks the Court to declare that, by adopting and maintaining in force provisions under which the tax on capital gains realised upon the sale of certain capital assets (‘the replaced assets’) is deferred by ‘transferring’ those capital gains to newly acquired or newly produced capital assets (‘the replacement assets’) until the sale of those replacement assets, on condition, however, that the latter form part of the assets of a permanent establishment of the taxable person located within the national territory, whereas such a deferral is not possible in the case where those assets form part of the assets of a permanent establishment of the taxable person located in another Member State of the European Union or in another State which is a party to the Agreement on the European Economic Area of 2 May 1992 (OJ 1994 L 1, p.

3; ‘the EEA Agreement’), the Federal Republic of Germany has failed to fulfil its obligations under Article 49 TFEU and Article 31 of the EEA Agreement.

Legal context

2 Paragraph 6b of the Law on Income Tax (Einkommensteuergesetz; ‘the EStG’) provides in subparagraphs 1 to 4:

‘(1) Taxable persons who sell

land,

plants which grow on the land with the land attached to them, where those plants are part of an agricultural or forestry undertaking,

buildings or boats intended for inland navigation,

may, during the financial year in which the sale took place, deduct an amount equivalent, at most, to the capital gain realised on the sale from the acquisition or production costs of the economic assets, referred to in the second sentence, which were acquired or produced during the financial year corresponding to the sale or during the previous financial year. The deduction shall be allowed for the acquisition or production costs of

1. land,

in so far as the capital gain was realised on the sale of land,

2. plants which grow on the land with the land attached to them, where the plants are part of an agricultural or forestry undertaking,

in so far as the capital gain was realised on the sale of land or on the sale of plants which grow on the land with the land attached to them,

3. buildings,

in so far as the capital gain was realised on the sale of land, of plants which grow on the land with the land attached to them, or of buildings, or

4. boats intended for inland navigation,

in so far as the capital gain was realised on the sale of boats intended for inland navigation.

The acquisition or production of buildings shall also cover their extension, expansion or renovation. In that case, the capital gain may be deducted only in respect of the costs incurred for the extension, expansion or renovation of buildings.

(2) The difference, after deduction of the sale costs, between the sale price and the book value which would have been attributable to the economic asset sold at the time of the sale is considered to be a capital gain within the meaning of the first sentence of subparagraph 1. The book value is the value which is to be attributed to an economic asset under Paragraph 6.

(3) If the taxpayer has not made the deduction referred to in subparagraph 1, he may, during the financial year in which the sale took place, establish a reserve reducing his taxable profit. The taxable person may, taking account of the restrictions referred to in the second to fourth sentences of subparagraph 1, deduct an amount not exceeding that reserve from the costs of the acquisition

or of the production of economic assets described in the second sentence of subparagraph 1, which have been acquired or produced during the subsequent four financial years, during the financial year corresponding to their acquisition or production. The four-year period shall be extended to six years for new buildings, where their production began before the end of the fourth financial year following the establishment of the reserve. The reserve must be included in the profits up to the amount deducted. If a reserve still exists at the end of the fourth financial year following its establishment, it must be included in the profits on that date, unless a deduction of production costs for buildings the production of which commenced at that time is not possible; if the reserve still exists at the end of the sixth financial year following its creation, it must be included in the profits on that date.

(4) The application of subparagraphs 1 and 3 shall be subject to the following conditions:

1. the taxable person must determine the profit under Paragraph 4(1) or Paragraph 5,

2. the economic assets sold must have constituted an integral part of the assets of a permanent establishment located within national territory for an uninterrupted period of at least six years at the time of the sale,

3. the economic assets acquired or produced must form part of the assets of a permanent establishment located within the national territory,

4. the capital gain realised on the sale must not be omitted from the calculation of the taxable profit within the national territory, and

5. the deduction under subparagraph 1 and the establishment of the reserve and its inclusion in the profits under subparagraph 3 must be capable of being traced in the accounts.

The deduction under subparagraphs 1 and 3 shall not be authorised for economic assets forming part of an agricultural or forestry undertaking or used in the context of an independent activity where the capital gain results from the sale of economic assets of an industrial undertaking or business.'

Pre-litigation procedure

3 On 15 May 2009, the Commission sent to the Federal Republic of Germany a letter of formal notice. By that letter, it drew the attention of that Member State to the risk that Paragraph 6b of the EStG might be incompatible with the free movement of capital.

4 By a letter of 13 July 2009, the Federal Republic of Germany expressed its disagreement with the Commission's position, contending that the legislation in dispute did not come under the free movement of capital, but solely under the freedom of establishment, with which it was compliant.

5 On 7 May 2010, the Commission sent to the Federal Republic of Germany a supplementary letter of formal notice in which it acknowledged that that legislation came under the freedom of establishment but in which it expressed the view, after examining the arguments of that Member State, that that legislation infringed Article 49 TFEU and Article 31 of the EEA Agreement.

6 By a letter of 7 July 2010, the Federal Republic of Germany took issue with the Commission's position, maintaining that the legislation at issue was compatible with the freedom of establishment.

7 On 30 September 2011, the Commission sent to the Federal Republic of Germany a

reasoned opinion in which it confirmed its position set out in the supplementary letter of formal notice and requested the Federal Republic of Germany to comply with that reasoned opinion within two months of its notification.

8 Since, in its reply of 28 November 2011, the Federal Republic of Germany repeated that the Commission's position was incorrect, the Commission decided to bring the present action.

The action

Admissibility

9 The Federal Republic of Germany disputes the admissibility of the present action on two grounds, to the effect, essentially, first, that there was a delay in bringing the action and, secondly, that the subject-matter of the action has been altered.

The delay in bringing the action

– Arguments of the parties

10 The Federal Republic of Germany maintains that the Commission was no longer entitled to bring an action by reason of the fact that, at the end of the written procedure, that institution overly delayed in bringing its action. Thus, it submits, the Commission committed an abuse of law since there was no objective reason to justify the delay found to have occurred. During that period of waiting, the Commission made no effort to reach an amicable solution to the dispute with that Member State.

11 Furthermore, the Federal Republic of Germany submits, it is necessary to take account of the general principles of legal certainty and sincere cooperation. Just as the Member States are required to cooperate with the Commission in order to bring to an end a failure to fulfil obligations under the FEU Treaty which has been established by the Court, so too the Commission must, during the period prior to bringing an action for failure to fulfil obligations, cooperate with the Member State concerned with a view to seeking alternatives to the bringing of such proceedings and inform that Member State of the progress of its actions. The principle of sincere cooperation, it argues, applies not only to the Member States but also to the Commission.

12 The Commission submits that the rules laid down in Article 258 TFEU apply without it being obliged to act within a specified period. In addition, according to the Commission, the considerations which determine the choice as to when the action for failure to fulfil obligations is brought cannot affect the admissibility of that action.

13 Criticism could, in the Commission's view, be justified only in the situation where the Member State concerned experiences difficulties in refuting the Commission's arguments by reason of the excessive length of the pre-litigation procedure, with the result that the rights of the defence are not respected. The Federal Republic of Germany, however, has never claimed that such a situation existed and no evidence to that effect can be found.

– Findings of the Court

14 According to settled case-law, it is for the Commission to choose when it will bring an action for failure to fulfil obligations. The considerations which determine its choice of time cannot affect the admissibility of the action. The rules laid down in Article 258 TFEU must be applied without any obligation on the Commission to act within a specific period, subject to situations in which the excessive duration of the pre-litigation procedure is liable to make it more difficult for the Member State concerned to refute the Commission's arguments and is thus liable to infringe the rights of

the defence. It is for the Member State concerned to adduce evidence that it has been affected by such an excessive duration (see, to that effect, judgment in *Commission* v *Lithuania*, C?350/08, EU:C:2010:642, paragraphs 33 and 34 and the case-law cited).

15 As the Commission has argued, the Federal Republic of Germany has not invoked the existence of such a situation. The plea of inadmissibility raised by that Member State must for that reason be rejected.

The alteration to the subject-matter of the action

– Arguments of the parties

16 The Federal Republic of Germany maintains that the argument relating to the taxation of capital gains in respect of the replaced asset, in the case where the replacement asset can be amortised, raised by the Commission in its reply, was not put forward in either the pre-litigation procedure or the application. According to that Member State, that fact should be regarded as amounting to an alteration to the subject-matter of the dispute, thus rendering the action inadmissible in its entirety.

17 The Commission replied, at the hearing, that the action is admissible. In its view, it is clear from the application that Paragraph 6b of the EStG must also apply to cross-border situations. It is true that, by contrast to what is allowed in respect of a replacement asset which cannot be amortised, in the case of a replacement asset which can be amortised the taxation of the capital gain made on the sale of the replaced asset can be deferred entirely until the sale of the replacement asset only to the extent corresponding to the amortisations of a lower amount related to the replacement asset. However, the fact remains that the taxation of the capital gain realised on the sale of the replaced asset is deferred in those two situations. The latter differ only in respect of the scope of the deferral. As regards the replacement assets which cannot be amortised, that deferral extends until those assets are sold, whereas, in the case of the replacement assets which can be amortised, the duration of their deferral might be shorter. In relation to that latter asset type, as regards amortisation, the Federal Republic of Germany could, under the rules laid down by the German legislation, require staggered payment of the tax.

– Findings of the Court

18 It must be noted that, in the present case, neither the propriety of the reasoned opinion nor that of the procedure prior to notification of that reasoned opinion is in dispute.

19 It follows from settled case-law that, under Article 258 TFEU, the subject-matter of an action for failure to fulfil obligations is determined by the Commission's reasoned opinion, with the result that the action must be based on the same grounds and pleas as that opinion. However, that requirement cannot be carried so far as to mean that in every case the statement of complaints in the operative part of the reasoned opinion and the form of order sought in the application must be exactly the same, where the subject-matter of the proceedings, as defined in the reasoned opinion, has not been extended or altered. In its application the Commission may, inter alia, clarify its initial complaints, provided, however, that it does not alter the subject-matter of the proceedings (see judgment in *Commission* v *Poland*, C?281/11, EU:C:2013:855, paragraphs 87 and 88 and the case-law cited).

20 In the present case, both in the pre-litigation procedure and before the Court, the Commission has made it clear that it was criticising the Federal Republic of Germany on the ground that, by adopting and maintaining in force the scheme provided for by Paragraph 6b of the EStG, it had failed to fulfil its obligations under Article 49 TFEU and Article 31 of the EEA

Agreement.

21 The application of that scheme has, essentially, as its consequence the deferral of the payment of the tax due on capital gains arising from the sale of replaced assets forming part of the assets of a permanent establishment of the taxable person located within German territory, on condition that those capital gains are reinvested in the acquisition or production of replacement assets. However, in order for the taxable person to benefit from that tax advantage, the replacement assets must form part of the assets of a permanent establishment which is also located within German territory, whereas that advantage is, by contrast, refused in the case where those assets form part of the assets of an establishment located in another Member State of the European Union or in another Member State of the European Economic Area. According to the Commission, it is that difference in treatment which constitutes the alleged infringement of the freedom of establishment.

22 In addressing, in its reply, the deferral of the taxation of capital gains realised pursuant to the rules on amortisation laid down by the German legislation, with regard to replacement assets which can be amortised, the Commission merely set out, in specifying them — in response to the Federal Republic of Germany’s criticism that the Commission had erred in stating that the taxation of capital gains resulting from the sale of replaced assets is, in all cases, deferred until the sale of the replacement assets — the arguments raised in support of its conclusions relating to the alleged failure to fulfil obligations, which had already been raised more generally in the pre-litigation procedure and in the application.

23 In this regard, it should be noted that the fact that the date on which the capital gain resulting from the sale of the replaced asset is taxed depends, according to that legislation, on whether or not the replacement asset can be amortised does not alter the subject-matter of the dispute. Irrespective of whether or not the replacement asset can be amortised, the recovery of the tax due on capital gains realised on the sale of the replaced asset is deferred in the two cases described, and the two situations at issue differ only as to the extent of that deferral. In the case of the replacement assets which cannot be amortised, that deferral could be prolonged until those assets are sold, whereas, in the case of assets which can be amortised, that deferral may be of a shorter duration. However, that advantage is offered, in both cases, only to reinvestments carried out for the purpose of the acquisition of replacement assets forming part of the assets of a permanent establishment of the taxable person located within German territory.

24 The mere fact that the Commission, in the pre-litigation phase and in the application, refers solely, with regard to the date on which the capital gains resulting from the sale of the replaced assets are taxed, to the sale of replacement assets, cannot, therefore, be regarded as demonstrating the existence of a new plea in law restricting the scope of the action to only those replacement assets which cannot be amortised.

25 Consequently, it must be held that the head of claim relied on by the Commission remained unchanged throughout the pre-litigation procedure and the judicial proceedings.

26 In view of the foregoing, it must be held that the Commission’s action is admissible.

Substance

Arguments of the parties

27 The Commission submits that Paragraph 6b of the EStG is contrary to the provisions of the FEU Treaty and of the EEA Agreement on the freedom of establishment.

28 Under Paragraph 6b, the taxable person is, according to the Commission, entitled to transfer to certain replacement assets, without their being taxed, the capital gains realised on the sale of certain investment assets forming part of the assets of a permanent establishment of that taxable person located within German territory, on condition that those capital gains are reinvested in the acquisition or production of those replacement assets. In the Commission’s view, such a deferral of taxation of those capital gains is, however, possible under Paragraph 6b(4)(3) of the EStG only if those replacement assets form part of the assets of a permanent establishment of the taxable person located within that territory. If the same replacement assets form part of the assets of a permanent establishment located outside that territory, the capital gains resulting from the sale of the replaced asset are, according to the Commission, subject to immediate taxation.

29 An economic operator will therefore take account of the fact that a reinvestment made outside Germany is fiscally less advantageous than a reinvestment carried out within German territory. That difference in treatment is, in the Commission’s view, liable to deter a company located within German territory from carrying out its activities through the intermediary of a permanent establishment located in a Member State of the European Union or of the EEA other than the Federal Republic of Germany.

30 Such a difference in treatment cannot, the Commission submits, be justified by an objective difference in situation. It maintains that, if the permanent establishment in which the reinvestment is made is located in a Member State of the European Union or of the EEA other than the Federal Republic of Germany, it can only be inferred from that fact that the economic operator concerned has exercised the freedom of establishment.

31 According to the Commission, the justifications based on the territoriality of the tax are unfounded. The present case concerns the capital gains generated within German territory on the sale of the replaced asset. The Federal Republic of Germany is unquestionably entitled to tax those capital gains. That right is, moreover, actually exercised by the immediate taxation of those capital gains in the case where they are reinvested outside German territory. In that context, the tax treatment of permanent establishments under agreements to prevent double taxation is, the Commission submits, irrelevant.

32 The fact that it might follow that the Federal Republic of Germany would also have to defer the date on which the tax on such capital gains is due in the case where the reinvestments are made outside German territory, as it does in relation to reinvestments carried out within that territory, does not in any way alter the allocation of the powers of taxation in relation to those capital gains.

33 With regard to the justification based on the need to preserve the coherence of the national tax system, this can succeed only if there is a direct link between the tax advantage concerned and the offsetting of that advantage by a specified tax burden. According to the Commission, the taxation of the capital gains realised on the sale of the replacement asset does not, in itself, constitute the counterpart to the deferral of the taxation of capital gains arising from the sale of the replaced asset. That tax advantage, namely the deferral of the taxation of those latter capital gains, has as its counterpart the subsequent taxation of the capital gains resulting from the sale of that same asset and not the taxation of the separate capital gains realised on the sale of the replacement asset.

34 In the Commission’s view, the desire to promote restructuring and reinvestment also does not constitute a legitimate objective. It is, moreover, irrelevant whether such a general and economic objective is capable of constituting an overriding public-interest ground in a specific case. In any event, the Federal Republic of Germany has neither argued nor demonstrated that

that objective could not be achieved without the cross-border reinvestments at issue being made subject to discriminatory treatment.

35 The legal construct chosen also does not constitute, in itself, a justification. The same would be true of objectives relating to national economic development. The mere fact that a tax advantage cannot be conferred by means of the same techniques in a cross-border situation and in a purely domestic situation does not in any way, according to the Commission, justify treating those situations differently.

36 As regards the question whether the measure at issue is proportionate, the Commission maintains that, in the absence of any relevant justification, that question does not arise.

37 In any event, according to the Commission, so far as concerns the administrative burdens to be borne by the taxable person, the Court concluded, in *National Grid Indus* (C?371/10, EU:C:2011:785), that a right exists for that taxable person to opt for immediate taxation or for deferred taxation. Accordingly, immediate taxation of the capital gains at issue would not be proportionate.

38 The Federal Republic of Germany submits, primarily, that the action is unfounded. It takes the view that the situation of a permanent establishment located in another Member State is not objectively comparable to that of an establishment located within German territory. In the alternative, that Member State contends that, if a restriction were found to exist, it would in any event be justified by overriding grounds of public interest based on the tax-territoriality principle and on the need to preserve the coherence of the national tax system.

39 The Federal Republic of Germany contends that the tax scheme provided for by the legislation at issue is devoid of deterrent effects liable to prevent the taxable person from setting up permanent establishments in other Member States and from carrying out its activities through such establishments. The fact of not being able to sell capital assets which form part of the assets of a permanent establishment located within German territory, without the capital gains realised at that time being taxed, does not, as such, directly affect the activities of a permanent establishment located in another Member State.

40 According to the Federal Republic of Germany, the objective pursued by Paragraph 6b of the EStG is to improve the cash flow of undertakings and to facilitate restructuring by encouraging reinvestments in the undertaking itself. Such reinvestments are necessary to enable previous levels of production to be achieved, by coping with the wear and tear of production assets or with technical progress. Opting out of the immediate taxation of the capital gains realised on the sale of the replaced asset allows the undertaking concerned to adapt, in economic terms, to the structural changes linked to production techniques and to distribution, or to changes of a regional nature. The reinvestment of those capital gains will facilitate the major restructuring of undertakings and also avoid the taxation of the particularly high capital gains which are realised on the sale of the asset concerned.

41 According to the Federal Republic of Germany, the tax regime provided for in Paragraph 6b of the EStG has the effect that the replaced asset and the replacement asset are considered to form a single asset, since, in economic terms, those two production assets generate revenue within German territory. This result is obtained by the fact that, for tax purposes, the replaced asset is treated in the same way as the replacement asset. The capital gains realised on the sale of the replaced asset are transferred, in the balance sheet of the undertaking concerned, to the replacement asset. The replaced asset is treated, in that balance sheet, as never having been removed from the undertaking’s operating capital. This fiction, according to which the replaced asset is continuously present in that capital could, from a technical point of view, be accepted only

in the event that the replacement asset forms part of the assets of the same taxable person and itself comes within the powers of taxation of the German authorities.

42 In accordance with the provisions of the agreements on preventing double taxation concluded by the Federal Republic of Germany, a permanent establishment is a separate entity for tax purposes. Accordingly, the replaced asset and the replacement asset are not in the hands of the same taxable person, but in the hands of different taxable persons, which are taxed by different Member States. It follows that the tax advantage provided for by the legislation at issue, which consists in the possibility of replacing a capital asset belonging to the same taxable person in a fiscally neutral manner, cannot, by its nature, be conferred in such circumstances. The Federal Republic of Germany does not have any other technique to enable it, legally or practically, to confer that specific type of tax advantage in a cross-border situation, as the economic assets of a permanent establishment located outside its territory are not subject to its powers of taxation.

43 The Federal Republic of Germany submits that the particular technique selected was not chosen arbitrarily in order to exclude cross-border situations from the outset. Rather, it was the only technique which made it possible to confer a tax advantage on reinvestments made by undertakings in a manner which was professionally and politically defensible.

44 According to the Federal Republic of Germany, the Commission wishes to establish a special incentive scheme for investment and for restructuring applicable to cross-border situations which does not apply to purely national companies. As such a scheme is not generally laid down by German law for purely internal situations, EU law, as it currently stands, cannot require the establishment of a special form of deferred taxation of capital gains. In the current state of the harmonisation of tax law at EU level, the Member States benefit from a degree of autonomy in tax matters. They are in no way obliged to adapt their own tax systems to the different tax systems of other Member States in order to ensure that a company which has chosen to become established in a given Member State is taxed, in that Member State, in the same way as a company which has chosen to become established in another Member State. This autonomy in tax matters also means that a Member State is free to determine the conditions and the level of taxation applicable to the different forms of establishment of national companies operating outside its territory, subject to the condition that those establishments are treated in a manner which is not discriminatory in relation to the treatment of comparable establishments established within national territory.

45 The tax scheme provided for in Paragraph 6b of the EStG is, according to the Federal Republic of Germany, justified, in any event, by the overriding public-interest ground based on the need to maintain the division of powers of taxation between the Member States. Pursuant to the agreements for the prevention of double taxation, the Federal Republic of Germany does not have, in tax matters, any power in respect of the replacement asset, and it cannot, therefore, either determine the amount of amortisation as regards that asset or collect the tax resulting from its sale. It is therefore not possible, on a technical level, to apply the scheme laid down in Paragraph 6b of the EStG to replacement assets belonging to a permanent establishment located outside German territory. Nor is there any other technique which would make it possible, legally or practically, to confer that specific type of tax advantage in a cross-border situation.

46 That tax scheme is also justified by the overriding public-interest ground based on the need to preserve the coherence of the national tax system. There is, in the view of the Federal Republic of Germany, a direct link between the tax advantage at issue and the offsetting of that advantage by a particular tax burden. The transfer, to the replacement asset, of the capital gains accruing from the sale of the replaced asset is, in practice, a fiction under which the replaced asset remains part of the operating capital of the undertaking concerned. From an economic point of view, the capital gains realised on the sale of the replaced asset and those resulting from the sale of the

replacement asset represent one and the same profit, in such a way that the taxation of the capital gains relating to that latter asset is inseparable from the taxation of those relating to the replaced asset. The arrangements for taxing the replacement asset thus constitute an integral part of the tax advantage at issue. The favourable tax treatment enjoyed by the capital gains realised on the sale of the replaced asset is also closely related to the taxation of the revenue generated with the help of the replacement asset within German territory.

47 Lastly, that tax scheme is justified by the overriding public-interest ground based on the political will to encourage reinvestments in the undertaking with a view to maintaining or modernising the production assets and to safeguarding continuity of production as well as preserving employment. That objective, which consists of encouraging reinvestment in the undertaking itself, in order to acquire a new capital asset corresponding to that which has been sold, can be achieved only if the taxation of that new asset is also a matter determined by the German tax authorities.

48 As regards the proportionality of the measure at issue, the Federal Republic of Germany maintains, primarily, that if there is no discrimination under EU law or if such discrimination is justified by overriding public-interest grounds, there would be no need to consider potentially less restrictive measures.

49 In the alternative, the Federal Republic of Germany submits that the measure laid down in Paragraph 6b of the EStG, the application of which is limited to the replacement assets forming part of the assets of a permanent establishment located within German territory, is proportionate.

50 According to that Member State, it would be difficult for it to find other equally appropriate measures which would be applicable to all cross-border situations. Those possible measures would not be less restrictive, since they would involve unreasonable administrative burdens both for the tax administration and for the taxable person.

51 The deferral of taxation of the capital gains at issue, applied to cross-border situations, would, the Federal Republic of Germany submits, have undesirable consequences. The extension of that tax advantage to those situations would be liable to lead directly to a transfer of capital assets and production facilities to places outside Germany. An incentive to relocate production outside Germany through stimulating reinvestment cannot, according to the Member State concerned, be required.

Findings of the Court

52 The Commission essentially criticises the Federal Republic of Germany for treating capital gains realised on the sale of certain capital assets forming part of the assets of a permanent establishment located within German territory, in the event of the reinvestment of those capital gains in certain replacement assets, newly acquired or produced, forming part of the assets of a permanent establishment of the taxable person located within the territory of another Member State of the European Union or of the EEA, more unfavourably than a similar reinvestment made within German territory.

53 The Commission argues that that difference in treatment is liable to create barriers to freedom of establishment and that it infringes Article 49 TFEU and Article 31 of the EEA Agreement.

– Infringement of the freedom of establishment laid down in Article 49 TFEU

54 Article 49 TFEU requires the elimination of restrictions on the freedom of establishment.

That freedom includes, for companies established in accordance with the legislation of a Member State and having their registered office, central administration or principal place of business within the European Union, the right to exercise their activity in other Member States through a subsidiary, branch or agency (judgment in *Commission* v *Denmark*, C?261/11, EU:C:2013:480, paragraph 25 and the case-law cited).

55 That freedom is also applicable to the transfer of activities of a taxable person from the territory of one Member State to another Member State (see, to that effect, *Commission* v *Denmark*, C?261/11, EU:C:2013:480, paragraph 28).

56 Although, according to their wording, the provisions of the FEU Treaty on the freedom of establishment are aimed at ensuring the benefit of national treatment in the host Member State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated in accordance with its legislation. All measures which prohibit, impede or render less attractive the exercise of the freedom of establishment must be considered to be restrictions on that freedom (judgment in *Commission* v *Denmark*, C?261/11, EU:C:2013:480, paragraphs 26 and 27 and the case-law cited).

57 In the present case, the tax scheme provided for in Paragraph 6b of the EStG has the effect of making the benefit of the deferral of recovery of the tax due on the capital gains arising from the sale of a capital asset forming part of the assets of a permanent establishment of the taxable person located within German territory subject to the condition that those capital gains are reinvested in the acquisition of replacement assets forming part of the assets of such an establishment located within the same territory. A similar reinvestment carried out for the purpose of acquiring replacement assets forming part of the assets of a permanent establishment of the taxable person located within the territory of another Member State leads, by contrast, to the immediate taxation of those capital gains.

58 It must be held that that difference in treatment with regard to the deferral of taxation of the capital gains at issue is liable to give rise to a cash-flow disadvantage for the taxable person wishing to reinvest those capital gains in order to acquire replacement assets intended for a permanent establishment located within the territory of a Member State other than the Federal Republic of Germany, in comparison with a taxable person who carries out a similar reinvestment in a permanent establishment located within German territory.

59 That difference in treatment is at the very least liable to make reinvestment effected outside Germany less attractive than reinvestment effected within Germany. It is, as the Commission submits, therefore liable to deter a taxable person established in Germany from carrying out its activities through a permanent establishment located within the territory of a Member State other than the Federal Republic Germany.

60 Such a difference in treatment cannot be explained by an objective difference in situation. In terms of legislation of a Member State which seeks to tax capital gains generated within its territory, the situation of a taxable person who reinvests those capital gains for the purpose of acquiring a replacement asset intended for a permanent establishment located within the territory of another Member State is, as regards the taxation of the capital gains which were generated in the first of those Member States prior to that reinvestment, similar to that of a taxable person who reinvests them in order to acquire a replacement asset intended for a permanent establishment located within the territory of that Member State.

61 It follows that, by making the benefit of the deferral of taxation of the capital gains realised on the sale of a capital asset forming part of the assets of a permanent establishment of the taxable person located within German territory subject to the condition that those capital gains are

reinvested for the purpose of the acquisition of replacement assets forming part of the assets of a permanent establishment of the taxable person located within that same territory, the tax scheme provided for in Paragraph 6b of the EStG constitutes a restriction on the freedom of establishment.

62 It is, however, necessary to determine whether that restriction may be objectively justified by overriding public-interest grounds recognised by EU law.

63 According to settled case-law, the freedom of establishment may be restricted by national legislation only if the restriction at issue is justified by overriding reasons in the public interest. It is further necessary, in such a case, that that restriction should be appropriate to ensuring the attainment of the objective in question and not go beyond what is necessary to attain that objective (see judgment in *DI. VI. Finanziaria di Diego della Valle & C.*, EU:C:2012:552, paragraph 41 and the case-law cited).

64 As regards, first of all, the justification based on the need to preserve the balanced allocation of the power to impose taxes between Member States, it should be recalled, first, that that justification is a legitimate objective recognised by the Court, and that, second, it is settled case-law that, in the absence of any unifying or harmonising measures of the European Union, the Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, with a view to eliminating double taxation (judgment in *DMC*, C?164/12, EU:C:2014:20, paragraphs 46 and 47 and the case-law cited).

65 In its judgment in *National Grid Indus* (C?371/10, EU:C:2011:785), the Court took the view, with regard to national legislation under which the transfer of the place of effective management of a company established under national law to another Member State resulted in the immediate taxation of the unrealised capital gains relating to the assets transferred, whereas such gains were taxed in the national context only where they were in fact realised, that such a transfer could not mean that the Member State of origin had to abandon its right to tax a capital gain which had been generated within the ambit of its powers of taxation prior to the transfer. The Court thus held that, in accordance with the principle of fiscal territoriality, a Member State was entitled to charge tax, at the time of that transfer, on the capital gains arising which had been generated within its territory. Such a measure was intended to prevent situations capable of jeopardising the right of the Member State of origin to exercise its powers of taxation in relation to activities carried on within its territory, and could therefore be justified on grounds connected with the preservation of the allocation of powers of taxation between the Member States (see, to that effect, judgment in *National Grid Indus*, C?371/10, EU:C:2011:785, paragraph 46 and the case-law cited).

66 The Court has also held that it is proportionate, for a Member State, for the purposes of safeguarding the exercise of its powers of taxation, to determine the tax due on the unrealised capital gains generated within its territory at the time when its power of taxation in respect of the company in question ceases to exist, in that case at the time of the transfer of the company’s place of effective management to another Member State (see, to that effect, judgment in *National Grid Indus*, C?371/10, EU:C:2011:785, paragraph 52).

67 By contrast, legislation of a Member State which requires the immediate recovery of the tax due in respect of the unrealised capital gains generated in the context of its fiscal jurisdiction, at the time of the transfer of the place of effective management of a company to a place outside its territory has been held to be disproportionate by reason of the fact that measures existed which were less restrictive of the freedom of establishment than the immediate recovery of that tax. In that regard, the Court has held that it was appropriate to give the taxable person the choice between, on the one hand, immediate payment of that tax, and, on the other hand, deferred payment of that tax, together with, if appropriate, interest in accordance with the applicable national legislation (see, to that effect, judgments in *National Grid Indus*, C?371/10,

EU:C:2011:785, paragraphs 73 and 85, and *DMC*, C?164/12, EU:C:2014:20, paragraph 61 and the case-law cited).

68 In the present case, it should be stated that the issue in question is the taxation of capital gains resulting from the sale of the replaced asset which were generated within the ambit of the fiscal jurisdiction of the Federal Republic of Germany. In that regard, it must be noted that the Commission does not dispute the right of that Member State to tax those capital gains.

69 Thus, in accordance with the case-law cited in paragraph 65 of the present judgment, a reinvestment of capital gains coming under the taxation powers of the Federal Republic of Germany, for the purposes of the acquisition of replacement assets intended for a permanent establishment of the taxable person located within the territory of another Member State, cannot mean that the Federal Republic of Germany is required to abandon its right to tax the capital gains generated within the ambit of its powers of taxation prior to the transfer of those capital gains outside its territory on the ground that they were reinvested for the acquisition of such replacement assets.

70 Even if the Federal Republic of Germany, by reason of the reinvestment of the capital gains resulting from the sale of replaced assets with a view to acquiring replacement assets forming part of the assets of a permanent establishment of the taxpayer located outside Germany, was not entitled to tax the revenue generated by those replacement assets, that Member State would not, however, be deprived of its right to tax the capital gains arising from the sale of the replaced assets which were generated within the ambit of its powers of taxation within its territory prior to that reinvestment. That right is, moreover, exercised by means of the immediate taxation of those capital gains at the time of such reinvestment.

71 In the present case, the fact that either an unrealised capital gain or a realised capital gain is at issue is irrelevant in this regard. What is of importance is that, as regards one or other of those capital gains, similar transactions, carried out in the purely domestic context of a Member State, unlike a cross-border transaction, did not result in the immediate taxation of those capital gains.

72 Although taxation of the capital gains at issue at the time of reinvestment of those gains, for the purpose of acquiring replacement assets outside the national territory, may be justified on grounds related to the need to preserve the division of the powers of taxation between the Member States, national legislation such as that here at issue, which has the effect of providing, in all cases, for the immediate recovery of tax on those capital gains at the time of their reinvestment outside the national territory, goes, as stated in paragraph 67 of the present judgment, in any event, by reason of the existence of measures which are less restrictive of the freedom of establishment than an immediate recovery of tax, beyond what is necessary to attain the objective related to the need to preserve the division of powers of taxation between the Member States.

73 Suffice it to state that it follows from the case-law of the Court that the taxable person should be given the choice of opting between, on the one hand, the fact of bearing the administrative burden relating to deferral of the charging of the tax at issue, and, on the other, the immediate recovery of that tax. In the event that the taxpayer considers that that burden is not excessive and chooses to bear it, the burden to be borne by the tax authorities cannot be regarded as excessive either (see, to that effect, *National Grid Indus*, C?371/10, EU:C:2011:785, paragraph 77).

74 The restriction at issue cannot, next, be justified by the need to guarantee the coherence of the national tax system, which the Court has recognised as constituting an overriding public-interest ground. For an argument based on such a justification to succeed, it is necessary that a direct link be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy (judgments in *Commission* v *Portugal*, C?345/05,

EU:C:2006:685, paragraph 29, and *Commission* v *Sweden*, C?104/06, EU:C:2007:40, paragraph 26).

75 In the present case, there is no such direct link. As noted by the Commission, the tax advantage at issue, namely the deferral of taxation of the capital gains resulting from the sale of the replaced asset, has as its counterpart, notwithstanding the technique adopted for conferring that tax advantage, the subsequent taxation of the capital gains arising from the sale of that replaced asset and not the taxation of the separate capital gains generated by the sale of the replacement asset.

76 As regards, finally, the objective pursued by the national legislation at issue, namely the desire to promote investment in the same undertaking and the restructuring of that undertaking, in order to ensure its continuity and to maintain employment in Germany, and, on the assumption that such considerations may, under certain circumstances and conditions, constitute acceptable justification for national legislation providing for a tax benefit for natural or legal persons (see, to that effect, judgment in *Geurts and Vogten*, C?464/05, EU:C:2007:631, paragraph 26), it does not appear that that objective can be achieved only if the replacement asset also comes within the powers of taxation of the German authorities.

77 That objective can be achieved without any need to lay down an obligation of reinvestment within the territory of the Member State concerned. That objective would be similarly achieved if the taxable person were to choose to reinvest the capital gains resulting from the sale of the replaced asset for the purposes of acquiring a replacement asset forming part of the assets of a permanent establishment located within the territory of another Member State rather than within Germany. Notwithstanding the categorisation, for tax purposes, of a permanent establishment located outside the national territory, under conventional tax law, and the tax treatment of the replacement asset under that law, the replacement asset would, in any event, be linked to the economic activity of the taxable person and would, therefore, contribute to enhancing the promotion of investment in the undertaking and the restructuring of that undertaking and could, accordingly, guarantee the continuity of that economic activity (see, to that effect, judgment in *Commission* v *Portugal*, C?345/05, EU:C:2006:685, paragraphs 31 to 33 and 35).

78 In that context, no relevance attaches to the mere fact that, in the case of reinvestment outside national territory, the power to tax revenue generated by the replacement asset may be a matter for another Member State. Suffice it, in that regard, to note that, in accordance with settled case-law, an objective of a purely economic nature, such as the desire to increase national tax revenue or to reduce that revenue, cannot constitute an overriding public-interest ground such as to justify a restriction on a fundamental freedom guaranteed by the Treaty (see judgments in *Verkooijen*, C?35/98, EU:C:2000:294, paragraphs 48 and 59, and *DI. VI. Finanziaria di Diego della Valle & C.*, C?380/11, EU:C:2012:552, paragraph 50).

79 It follows that it must be held that the Commission’s head of claim alleging infringement of Article 49 TFEU is well founded.

– Infringement of Article 31 of the EEA Agreement

80 The rules prohibiting restrictions on the freedom of establishment laid down in Article 31 of the EEA Agreement are identical to those laid down by Article 49 TFEU. The Court has accordingly specified that, in the field at issue, the rules laid down by the EEA Agreement and those laid down by the FEU Treaty must be given a uniform interpretation (judgment in *Commission* v *Denmark*, C?261/11, EU:C:2013:480, paragraph 42 and the case-law cited).

81 However, EU case-law which relates to restrictions on the exercise of freedom of movement

within the European Union cannot be transposed in its entirety to the freedoms guaranteed by the EEA Agreement, since those latter freedoms are exercised within a different legal context (judgment in *Commission* v *Denmark*, C?261/11, EU:C:2013:480, paragraph 44 and the case-law cited).

82 In the present case, the Federal Republic of Germany has not indicated why the considerations relating to the obstacle to the freedom of establishment prohibited in Article 49 TFEU and its lack of justification cannot be transposed *mutatis mutandis* to Article 31 of the EEA Agreement. In those circumstances, it is appropriate to take the view that the Commission's head of claim alleging infringement of Article 31 of the EEA Agreement is also well founded.

83 It follows from all of the foregoing considerations that it must be held that, by adopting and maintaining in force the tax scheme provided for in Paragraph 6b of the EStG, which makes the benefit of the deferral of taxation of the capital gains realised on the sale of a capital asset forming part of the assets of a permanent establishment of the taxable person located within German territory subject to the condition that those capital gains are reinvested in the acquisition of replacement assets forming part of the assets of a permanent establishment of the taxable person located within that territory, the Federal Republic of Germany has failed to fulfil its obligations under Article 49 TFEU and Article 31 of the EEA Agreement.

Costs

84 Under Article 138(1) of the Rules of Procedure of the Court of Justice, 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 Federal Republic of Germany has been unsuccessful, the latter must be ordered to pay the costs.

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

1. **Declares that, by adopting and maintaining in force the tax scheme provided for in Paragraph 6b of the Law on Income Tax (Einkommensteuergesetz), which makes the benefit of the deferral of taxation of the capital gains realised on the sale of a capital asset forming part of the assets of a permanent establishment of the taxable person located within German territory subject to the condition that those capital gains are reinvested in the acquisition of replacement assets forming part of the assets of a permanent establishment of the taxable person located within that territory, the Federal Republic of Germany has failed to fulfil its obligations under Article 49 TFEU and Article 31 of the Agreement on the European Economic Area of 2 May 1992;**

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

[Signatures]

* Language of the case: German.