

Newsalert

EU Direct Tax Group

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JUDGMENT IN CASE C-403/03 (SCHEMP) : DEDUCTIBILITY OF CROSS-BORDER MAINTENANCE PAYMENTS

Mr. Schempp is a German citizen and lives in Germany. He made maintenance payments to his former spouse, who lives in Austria, and sought to deduct these in accordance with Sec. 1a (1) of the German Income Tax Act. Deduction is granted for payments to German residents and further to residents of the European Economic Area (EU Member States, Iceland, Liechtenstein and Norway), if it is proved that the payments are subject to tax in the State of residence of the recipient. Since maintenance payments are not taxable in Austria, Mr. Schempp was denied such deduction by the German tax administration. He appealed against his tax assessment and after proceedings in the lower Tax Court, the German Supreme Tax Court referred the case to the ECJ and asked whether it is incompatible with either Art. 12 (prohibition of discrimination on grounds of nationality) or Art. 18 (right to move and reside freely within the EU) of the EC Treaty that a taxpayer is denied deduction of maintenance payments because his former spouse is now resident in Austria, if he would be entitled to such deduction, had his former spouse been resident in Germany?

In its judgment of July 12, the Grand Chamber of the ECJ held that the denial of deduction is not in breach of either Art. 12 or Art. 18 of the EC Treaty. It thereby followed the Opinion of the Advocate General *Geelhoed* from January this year.

The ECJ initially stated that Mr. Schempp's situation was not an internal situation with no connection to Community law, since the denial of deduction was a direct result of his former spouse exercising her right to move to Austria, as guaranteed by Art. 18 of the EC Treaty. The Court then went on to say that there is no discrimination on grounds of nationality, since discrimination requires that comparable situations are treated differently, or different situations comparably: the payments to a recipient in Austria cannot be compared with payments to a recipient in Germany, as the German and Austrian tax systems differ in respect of the taxation of maintenance payments. The ECJ rejected Mr. Schempp's argument that discrimination does occur if only because the deductibility of payments made to a German recipient is not dependant on the recipient actually paying tax, whereas the deductibility of payments to a person resident outside Germany is. Moreover, the argument that the maintenance payments would also have remained untaxed if Mr. Schempp's former spouse had been resident in Germany, since her income was below the tax-free amount, was dismissed on the grounds that the *non-taxable* character of the payments in Austria could not be compared with an (actual) *non-taxation* of these in Germany. The ECJ also rejected the alleged breach of Art. 18, thereby reasoning that the EC Treaty does not offer a guarantee to citizens that a transfer of activities to another Member State is neutral in respect of taxation. This applies *a fortiori* if not the complaining taxpayer himself, but his former spouse had made use of the right to move within the EU.

Particularly noteworthy is the statement that *non-taxability* is different than an actual *non-taxation*, even if the practical result is the same. Since the ECJ did not give an answer to the question if a deduction must be allowed in case of actual non-taxation in a Member State that normally taxes maintenance payments, the outcome might be different if the recipient of the payments is resident in or national of another Member State than Austria. The ECJ did also not deal with the free movement of capital of Art. 56 of the EC treaty that the Advocate General shortly touched upon in his Opinion.

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