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ECJ CASES

Austria - Free movement of capital and third countries: Holböck case (C-157/05)

An individual shareholder resident in Austria received dividends from a corporation resident in Switzerland on which he held two thirds of the shares. Dividends from non-EU Member States were - according to the legal status relevant for this case - taxed at the full progressive tax rate (up to 50%). On the other hand dividends from domestic companies to Austrian residents are only taxed at the half average tax rate. In the meantime (starting from 1 April 2003) all dividends received - either domestic or foreign - are taxed either at a flat rate of 25% or at the half average tax rate. The Austrian High Administrative Court could not determine whether those national rules were in line with EU law, and in particular with the freedom of capital movement according to articles 56 and 57 of the EC treaty. This case is especially interesting with respect to two aspects which until now have not been decided by the ECJ yet. First, the question which was not clarified in the Lenz case, is whether or not investment income deriving from non-EU Member States are covered by the free movement of capital. The second question which was not clarified in the Manninen case, concerns the coherence principle, e.g. whether the amount of taxation in the non-member state is of any relevance for a potential infringement.

Belgium - Inbound dividends: Foreign tax credit for EU dividends, Kerckaert-Morres Case (C- 513/04)

On 1 December 2004, a Belgian lower court referred a case to the ECJ for a preliminary ruling. The case was concerned with the absence of a Belgian foreign tax credit (“FBB/QFIE”) for inbound dividends received by a Belgian individual from a French company on which French withholding tax was levied. Although according to Belgian tax law, inbound dividends are taxed in the same way as domestic dividends, inbound dividends are subject to a higher tax burden due to the combined effect of the foreign withholding tax and the absence of tax credit in Belgium. Most double tax treaties concluded by Belgium stipulate that Belgium must grant a foreign tax credit in relation to inbound dividends, according to Belgian internal law. However, in 1988 the foreign tax credit in relation to dividends was entirely abolished in Belgian domestic law. If the ECJ rules that the absence of a foreign tax credit violates the free movement of capital, Belgium will probably have to reconsider how it deals with foreign withholding tax on dividends.

Belgium - Pension funds: Tax treatment of pension capital, Commission v. Belgium (C-522/04)

On 23 December 2004, the Commission brought an action before the ECJ against Belgium in respect of pension funds. In December 2003, the Commission sent Belgium a formal request to change its legislation in the form of a “reasoned opinion”. Since Belgium’s commitment to change its law was too imprecise and the proposed September 2005 implementing date too late, the Commission referred the case to the ECJ. Belgian domestic law poses the following problems: (1) The employer’s contributions for supplementary pension funding are tax deductible provided the contributions are paid to an insurance fund established in Belgium; (2) The employees’ contributions for supplementary pension funding give rise to a reduction of tax provided the contributions are paid to an insurance fund established in Belgium; (3) If a Belgian resident transfers his residence abroad, the payment or allocation of the pension is deemed to have taken place the day preceding the transfer; (4) If the capital of a supplementary pension fund constituted by means of employers’ or employees’ contributions made to an insurance fund established in Belgium is transferred to another insurance fund established abroad, the payment or allocation of the pension is deemed to have taken place the day of the transfer; (5) Foreign insurers who have no operational headquarters in Belgium need to designate a tax representative in Belgium before offering their services on Belgian territory. The Commission has stated that the Belgian tax rules contain restrictions on all four EC Treaty freedoms: free movement of services, workers, establishment and capital.

Finland - Cross-border loss relief: 'Marks and Spencer' with a Nordic flavour

On 23 May 2005 the Finnish Supreme Administrative Court referred a case to the ECJ, which is similar to the Marks and Spencer case. The key question is whether a Finnish company can under EU law make a tax deductible contribution to a UK company belonging to the same group. In accordance with the Finnish domestic law, a Finnish company can do so to another Finnish company. The group contribution is tax deductible for the contributing company and taxable income for the recipient. The group contribution system enables the offsetting of the profits and losses between group companies, but it also provides for a mechanism to repatriate profits generated in the (Finnish) lower-tier group companies to the (Finnish) parent company. The Ministry of Finance has hinted that the group contribution system could be abolished following the A-G's conclusions in the Marks and Spencer Case, provided that the ECJ follows the A-G's Opinion. On the other hand, there are still certain differences between the Finnish system and the UK group relief system (under review in the Marks and Spencer case), and therefore the Finnish government might - before drawing any conclusions on the future of the group contribution system - wait until the ECJ decision on the case referred by the Supreme Administrative Court. It should be noted that, as similar group relief systems are in place in Sweden and also Norway (both belonging to the EEA), the case might have major implications on the tax system of those countries as well.

France - Outbound dividends: Denkavit case

On 15 December 2004 (Société Denkavit International BV and SARL Denkavit France), the French Supreme Court (Court) posed preliminary questions to the ECJ relating to the former French dividend withholding tax system (applicable before 1992) on outbound dividends. France imposed a withholding tax at a domestic rate of 25% on dividend distributions by a French company to its Dutch parent company, while dividend distributions to a French parent company are not subject to withholding tax. This rate was, subject to certain conditions, reduced to 5% on the basis of the Dutch- French tax treaty. Moreover, the Netherlands have to provide for relief of double taxation on the basis of said treaty to the extent that these dividends are included in the taxable base of the Dutch parent company. The Court posed three preliminary questions. Firstly, whether the provision, which imposes a tax burden on a non-French parent company (beneficiary of the dividend; whereas an exemption applies to French parent companies) constitutes an infringement of the freedom of establishment. Secondly, when considering the compatibility of the provision in question with the EU rules on the freedom of establishment, whether it is appropriate to take account of the fact that the applicable tax treaty allows France to levy a withholding tax at a reduced rate and provides for a relief of double taxation for the recipient. Thirdly, if the existence of a tax treaty can be taken into account, does the fact that the foreign parent company is not able to make use of the relief for double taxation provided for under the tax treaty, render the provision incompatible with the EU provisions on the freedom of establishment? The consequences of the ECJ's decision will be important and should not be limited to the former regime. In fact, in France, and presumably in many other countries, it should be noted that the conditions required for the application of the current withholding tax exemption regime are more rigorous than those required for the domestic participation exemption regime. A new debate may be opened on this issue in France.

Germany - Branch taxation: German system not compatible with EU law according to A-G in CLT-UFA case (C-253/03)

In his Opinion on the CLT-UFA case handed down on 14 April, the Advocate-General (A-G) Léger held that the former German corporation tax rate for branches of non-resident corporations is not in line with the freedom of establishment. Under the old German imputation tax system, domestic subsidiaries benefited from a reduced tax rate when profits were distributed. However, this reduced tax rate was not available to branches of non-resident corporations. The higher tax rate for branches was applicable under the former German imputation tax system until the fiscal year 2001. A-G Léger based his analysis on the free choice of legal form which according to the jurisprudence of the ECJ is inherent in the freedom of establishment. Based on this principle, the A-G considered that the former German corporation tax provisions were an infringement of the freedom of

establishment principle, as branches did not benefit from the same tax rate as subsidiaries. Even though under the former German tax regime the tax rate for subsidiaries might have been higher under certain conditions, the A-G did not find it could be seriously disputed that the tax rate for branches had adverse tax consequences in the majority of cases. Contrary to the view of the German Government, the A-G considered branches and subsidiaries to be in a comparable situation with regard to the determination of the corporation tax rate. Because branches and subsidiaries were in all other respects subject to the same tax provisions he felt that Germany acknowledged the comparability of both legal forms for tax purposes. A supplementary question to the preliminary ruling request asked whether the tax rate had to be reduced in the year of income recognition. Here, the A-G suggested that the German Supreme Tax Court was competent on the matter. However, the A-G contended that the German court should consider the taxation of the subsidiary as the relevant comparison. Therefore, the additional 5% dividend withholding tax charged to the parent company on dividends from a subsidiary should also be taken into account.

Netherlands - Personal income tax allowances: Blanckaert v. Inspecteur van de Belastingdienst (C-512/03)

The Advocate-General (A-G) of the ECJ gave her opinion in the case of J.E.J. Blanckaert v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen Buitenland te Heerlen (C-512/03) on 12 May 2005. The Court of Appeal of 's-Hertogenbosch had requested a preliminary ruling from the ECJ on 14 December 2003 on the following questions: (i) whether or not a non-resident taxpayer, who only derived passive income and was not insured in respect of general social security in the Netherlands, is entitled to the social security part of the general levy rebate; and (ii) whether or not it is of importance that the taxpayer obtained less than 90% of his income in the Netherlands and did not opt to be taxed as a resident taxpayer. According to the A-G, the different treatment is not directly based on the place of residence of the taxpayer, as a non-resident would be entitled to the social security part of the general levy rebate if he derived employment income in the Netherlands and therefore would be subject to general social security. The A-G held that non-residents only deriving income from savings and investments in the Netherlands are not in a comparable situation with residents only deriving income from savings and investments, as only the latter are subject to general social security. The A-G also indicated that the Dutch regulations are coherent in taking into account their aim of guaranteeing an existing minimum and also the fact that residents are only entitled to the social security part of the general levy rebate in so far as they are insured in respect of the various general social security provisions. Finally, the A-G concluded that a different treatment between residents and non-residents with only income from savings and investments is objectively justified because only residents are entitled to the social security part of the general levy rebate.

Sweden - Outbound dividends: Skatteverket v. A (C-101/05)

On 15 October 2004, the Regeringsrätten (the Supreme Administrative Court of Sweden) referred a case to the ECJ for a preliminary ruling. The case concerned the question of whether a dividend distribution from a parent company, in the form of shares in its subsidiary located in a third state, should be exempt from tax according to CH. 42 Sec. 16 Income Tax Law (the 'Lex ASEA' rule). The Lex ASEA rule allows a tax neutral spin-off of a company quoted on a Swedish or a foreign stock exchange. Dividend distributions by a Swedish or a non-resident subsidiary to its shareholders, are tax exempt provided that certain conditions are met. The rule applies to companies established within the EU or in a state with which Sweden has concluded a tax treaty that includes an exchange of information provision (CH 42 Sec 16a IL). The treaty between Sweden and Switzerland (the applicable treaty in this case) does not include such an exchange of information provision. The Regeringsrätten asked the ECJ if it is contrary to the EU's provisions on the free movement of capital between Member States and third countries to tax A (the distributing company) in respect of the distribution from X (the distributing company) because X is not established in a state within the EEA or in a state with which Sweden has a taxation convention that contains a provision on exchange of information?

Sweden - Inbound dividends: Skatteverket v. A and B (C-102/05)

On 15 October 2004, the Regeringsrätten also referred a case to the ECJ for a preliminary ruling centering around the question of whether remuneration paid to employees working for a branch established in a third state, i.e. not being subject to payments of social security contributions according to Swedish law, should be included when computing the aggregate amount of payroll costs paid in accordance with CH. 43 Sec. 12 IL. According to Swedish law, resident individual shareholders of unlisted Swedish and non-resident companies are exempt from tax on dividends received up to a certain amount. The payroll costs subject to Swedish social security contributions shall be taken into account when computing this tax-exempt amount, thereby excluding remuneration paid to employees working for a branch established in a third state. On the basis of previous case law of the Regeringsrätten this rule constitutes a restriction on the freedom of establishment. The Regeringsrätten ruled in this case law that the remuneration paid to employees in subsidiaries in other EU Member States, that are not subject to Swedish social security contributions payments, should be included in computing payroll costs for the purposes of applying the tax relief under CH. 43 Sec. 3 IL. The Regeringsrätten referred the following questions to the ECJ: (i) is it contrary to the provisions on free movement of capital between the Member States and third countries, in a situation like the present case, for A and B to be taxed less favourably in respect of dividends from X because X's subsidiary Y conducts business in Russia rather than in Sweden; and (ii) if it is has any relevance whether A and B acquired shares in X before or after business in Russia was commenced or modified?

United Kingdom - Cross-border loss relief: Opinion of the A-G in the Marks and Spencer case (C-446/03)

The Advocate-General (A-G) held on 7 April 2005 that Articles 43 and 48 of the EC Treaty on the freedom of establishment preclude tax legislation of a Member State from prohibiting a parent company established in that Member State from benefiting from the right to group relief on the ground that its subsidiaries are established in other Member States, whereas that relief would be granted if those subsidiaries were resident in that Member State. The A-G went on, however, to opine that Articles 43 and 48 do not preclude national legislation from making entitlement to group relief subject to the condition that it is established that the losses of subsidiaries resident in other Member States cannot be accorded "equivalent tax treatment" in those Member States. However, the UK legislation does not currently contain any such provision in respect of the non-UK activities of a non-UK resident company. The A-G considers that "equivalent tax treatment" is where the losses of foreign subsidiaries are either capable of being transferred (to another legal person) or carried forward in the state of establishment. If the full court follows the A-G's opinion, which is normally the case, then the denial of cross-border group relief would be a breach of the EC Treaty where there was neither any relief for the losses of the non-UK EU subsidiary against profits of another legal person within the relevant subsidiary's taxing jurisdiction, nor where the losses of a foreign subsidiary were capable of being carried forward. The A-G has not expressly stated that his reference to the losses being capable of being carried forward requires that such losses are ultimately used against local taxable profits (as otherwise there is no economic benefit from that loss whatsoever).

NATIONAL DEVELOPMENTS

Austria - Inbound dividends: Tax treatment of cross-border dividends violates EU law

In a ruling issued on 13 January 2005, the Austrian Independent Tax Senate stated that the minimum holding requirements for the exemption of foreign dividends breach the principles of free movement of capital and freedom of establishment. Dividends paid by domestic companies to corporate shareholders are exempt from corporate income tax irrespective of the shareholding period or percentage. The tax exemption for dividends from foreign companies to corporate shareholders requires a participation of at least 10% to be held for an uninterrupted period of at least one year. In the opinion of the Senate the exemption of foreign dividends must not be subject to more restrictive conditions than the exemption of domestic dividends. This discrimination cannot be justified by compliance with the EU Parent-Subsidiary Directive. As the tax treatment of foreign dividends breaches the principle of free movement of capital, discrimination is also assumed for dividends from non-EU or non-EEA based companies. The ruling also applies to dividends received via investment funds or partnerships. As, according to the Senate, the ECJ's interpretation of the principles of free movement of capital and freedom of establishment was clearly expressed in comparable previous judgements, a preliminary ECJ ruling prior to the Senate's decision was not considered necessary. However, the tax office filed an appeal against this decision with the Administrative High Court.

Belgium - Inbound dividends: Amendments to the regime for dividend taxation

On 31 May 2005, some amendments to the Belgian dividend received deduction ("DRD") regime were published in the Official Gazette. According to article 4 of the EU Parent-Subsidiary Directive, when a shareholder-company receives dividend from a subsidiary, the Member State of the shareholder should accept the deduction of the tax relating to this dividend. Under Belgian income tax law, this principle is implemented by the DRD regime. DRD can be offset against the taxable basis of the year at hand. The taxable basis has to be decreased with certain disallowed expenses, which include amongst others fines and penalties, car expenses, granted abnormal or benevolent advantages and meal vouchers. As from fiscal year 2005, the taxable basis can no longer be decreased by the disallowed expenses. These amendments follow a "reasoned opinion" which was issued by the European Commission on 27 October 2003, and which required the Belgian Government to amend its participation exemption regime in accordance with the Parent-Sub Directive. In January 2004, the Ministry of Finance announced that the amendments would become effective from fiscal year 2005. Please note that a case pertaining to the Belgian DRD regime is still pending before the Brussels Court of Appeal. As, under Belgian tax law, DRD is limited to the total taxable profit of the year, a company closing its financial year in a loss-position, will not be able to offset the amount of the DRD. In addition, Belgian tax law does not provide for a carry-forward of the DRD exceeding the taxable profit. On 25 April 2003, the Brussels Court of First Instance concluded that the DRD regime was not compliant with the Parent-Sub Directive. Indeed, by providing a dividend deduction only up to the amount of the (positive) taxable basis, the DRD regime does not fulfill the purpose of this Directive, which is to avoid the double taxation of dividend repatriation.

Finland - Inbound dividends: Response to the ECJ's Manninen ruling (C-319/02)

On 13 May 2005, in the aftermath of the ECJ's decision in the Manninen case and a subsequent ruling by the Finnish Supreme Administrative Court, the Finnish Government presented a bill to Parliament on the refund procedure for taxes imposed on EEA-sourced dividends. Under the proposed law, Finnish residents who have received taxable dividends during the period 1998 to 2004 from companies within the EEA, would be entitled to imputation credit on such dividends. The imputation credit would be determined on the basis of the income taxes actually paid by the dividend distributor and the total amount of distributed dividend. The tax authorities would ex officio acquire the information needed to determine the imputation credit - mainly from the tax authorities of the distributing company's state of residence, or, alternatively, from the financial statements of the

distributing company. In case this information would not be available to the tax authorities, the imputation credit would be calculated on the basis of the Finnish tax rate, which amount would in any case constitute the ceiling for the imputation credit. Under the proposed law, Finnish corporate tax payers could reclaim dividend taxes - that have been excessive taking into consideration the imputation credit - by making an application to the tax authorities. Individuals would generally receive the refund of said taxes without any separate application. Details of the application procedure would be issued as soon as the new law has entered into force.

France - Abuse of law: Supreme court rules French legislation compatible with EU law
In a decision of 18 May 2005 (case No. 267087), the French Supreme Administrative Court (court) held that the French abuse of law legislation (Art. L 64 of the Tax Procedures Code, or LPF) is compatible with the freedom of establishment as set out in Art. 43 of the EC Treaty. The case concerned a French resident company that held 16.66% in the capital of a 1929 Luxembourg holding company. The holding was sufficient to make it eligible for the French participation exemption regime in respect of the distributions received from the 1929 holding company (a minimum holding requirement of 10% at the time), but also to exclude the application of the French CFC rules (a minimum 25% holding requirement at the time). Within the framework of an audit, the French tax authorities considered that the structure represented an abuse of law falling under Art. L 64 of the LPF. The provisions of Art. L 64 of the LPF authorize the tax authorities to disregard structures, which, albeit regular in appearance, are artificial and motivated by tax considerations only and, as a result, disallowed the participation exemption in respect of the distributions and the liquidation proceeds received from the 1929 holding company (which was liquidated in 1991). Before the court, the taxpayer argued that (i) the structure was motivated by legitimate business considerations and that (ii) Art. L 64 of the LPF was incompatible with the freedom of establishment set out in Art. 43 of the EC Treaty. In a first step, the court rejected the taxpayer's arguments, notably because the Luxembourg structure lacked substance, providing the same reasoning as that developed in a decision of 18 February 2004, which was given in respect of the same tax planning structure. In a second step, the court examined the compatibility of Art. 64 of the LPF with Art. 43 of the EC Treaty. It rejected the argument of the taxpayer who held that Art. L 64 of the LPF is likely to restrict the exercise of the freedom of establishment, as its application is likely to dissuade a taxpayer from establishing itself in an other EU Member State, notably if such an establishment is motivated by tax reasons. The court held that Art. 64 of LPF is intended to exclude specifically from the benefit of beneficial tax provisions purely artificial structures the sole purpose of which is to avoid French tax law. It, therefore, concluded that Art. 64 of the LPF is compatible with Art. 43 of the EC Treaty. The court notably did not refer the question of the compatibility of Art. L 64 of the LPF to the ECJ. It seems, however, that the court's decision is in line with the ECJ criteria. Indeed, the ECJ has notably judged unacceptable tax avoidance as a "wholly artificial arrangement" aimed at not having to pay tax (the ICI Case). In addition, although the ECJ has recognized that the prevention of abuse may justify restrictions on the exercise of the EC Treaty freedoms (Avoir Fiscal Case), such a justification has so far never been applied by the ECJ.

Germany - Exit tax: Reaction to EC Treaty infringement proceedings (Article 226 EC)
In the aftermath of the ECJ's ruling in the French case C-9/02 (de Lasteyrie du Saillant), the EU Commission opened EC Treaty infringement procedures (Article 226) against Germany in April 2004 by formally requesting Germany to abolish its "exit tax" provisions. The Commission considers that Germany's exit tax regime (Article 6 of International Tax Transactions Act, ITTA) is incompatible with EC Treaty rules on people's right to reside, work and establish themselves in another Member State (Articles 18, 39 and 43 of the EC Treaty). Under the terms of Article 6 ITTA, individual taxpayers who have been subject to unlimited income tax liability in Germany for a period of at least ten years and who have held a direct or indirect participation in a German limited company of at least one percent during the last five years, are subject to German income tax on their unrealized capital gains if they leave the country. By contrast, capital gains are taxed for residents in Germany only if they are realized. The Commission considers that there is no

justification for such an obvious hindrance to the free movement of persons within the Internal Market. The Commission recognizes that Germany may legitimately tax capital gains. The violation of EU law does not therefore result from the fact of taxing capital gains as such, but rather from the fact that the tax liability is triggered before the gains are realized only in the case of those taxpayers that move abroad. In a decree dated 8 June 2005, the German Federal Minister of Finance officially announced the amendment of Article 6 ITTA and set interim guidelines for applying the existing law rule to taxpayers moving to another EU/EEA Member State. These interim guidelines still follow the concept of taxing a deemed capital gain upon the exit from Germany. The major change refers to the conditions for and the extent of a deferral of the tax payments. Under the existing Article 6 ITTA, a deferral is subject to application, is interest-bearing, requires a deposit and is limited to 5 years at maximum. According to the interim guidelines, the deferral is without application, without interest, without deposit and without temporal limit. The deferral ends either with the actual disposal of the shares or when the taxpayer is not resident for tax purposes anymore in any of the EU/EEA Member States. Accordingly, the deferral requires that the taxpayer confirms his residence in one of the EU/EEA Member States and his ownership of the shares on an annual basis towards his former German tax office. The actual amendment of Article 6 ITTA itself was planned to be part of a comprehensive tax bill currently being drafted in the tax administration and comprising in addition the implementation of the amended merger directive, an extensive modernization of the German reorganization law and a legislative reaction to the EJC's ruling in the Gerritse case (C-234/01). The extraordinary federal elections that are expected for September 2005 will at least delay the legislative proceedings for this bill. It remains to be seen whether the amendment of Article 6 ITTA will finally have to be done through an isolated bill in order to avoid a referral of the matter to the ECJ by the Commission.

Germany - Cross-border relief for "tax-exempt" (branch) losses

In its decision on 14 February 2005 (1-V-305/04), the Lower Tax Court of Munich granted preliminary suspension of the tax assessments based on serious doubts regarding the compatibility of the treatment of foreign losses in cases, where corresponding foreign profits would be tax-exempt according to a double tax convention with the EC Treaty. The case concerns lawyers resident in Germany who applied for losses realized in their Belgian office to be offset against corresponding profits from their German office. Under the double tax convention with Belgium, income from the Belgian branch would be taxed in Belgium and be tax-exempt in Germany. According to repeated jurisdiction of the German Supreme Tax Court over decades, this tax-exemption for the foreign income also implies a tax-exemption for corresponding foreign losses. The German Supreme Tax Court has made clear in the meantime, that its interpretation of the German double tax conventions has remained unaffected by a contrary decision of the Austrian Supreme Tax Court from 2001. So, based on the double tax convention, the losses could only be considered under exemption with progression. Re-confirming this result based on domestic law, the Lower Tax Court of Munich has serious doubts as to its compatibility with the freedom of establishment (Article 43 EC). The fact, that losses from a second German branch could have been offset against income from the first German branch without restrictions whereas such relief is denied where the second branch is situated in another Member State, could prevent German residents from making use of their freedom of establishment in this other Member State. This case, which is still pending with the Lower Tax Court of Munich, merely joins a queue of comparable cases waiting for a decision: The above questions relating to losses which are tax-exempt by double tax conventions is also relevant in the Ritter-Coulais case (C-152-03) pending with the ECJ. In addition, two cases regarding foreign branch losses are pending with the German Supreme Tax Court: The case I-R-84/04 concerns relief for losses from a Luxembourg branch; the case I-R-166/04 refers to losses from a US-based partnership and thus even extends the question at the same time to the scope of application of the free movement of capital towards third countries.

Ireland - 2005 Finance Act: Recent changes triggered by EC Treaty non-discrimination requirements

The recently enacted 2005 Finance Act contained a number of measures that may have been necessitated by the non-discrimination requirements of the EC Treaty. Hitherto, deposit interest from Irish based financial institutions has been subject to favourable tax treatment, in that the withholding tax of 20% deducted from payments of deposit interest satisfied the final tax liability of individuals resident in Ireland. This resulted in a preferential treatment for Irish-based financial institutions by comparison with financial institutions established elsewhere in the EU since in the latter case an Irish resident individual, although not suffering Irish withholding tax, would be taxable at the marginal personal income tax rate (up to 42%). The new provisions, which apply for 2005 and subsequent years, equalize the tax treatment of deposit interest from Irish and other EU sources in the hands of Irish resident individuals. Thus the tax liability of interest from EU (non-Irish) financial institutions will be confined to 20%, enabling them to compete with Irish financial institutions on an after-tax basis.

Finance Act 2005 also made changes to the tax treatment of pension contributions by Irish individuals to EU (non-Irish) pension schemes. Previously, Irish individuals could only claim a deduction from their taxable income for pension contributions where these were paid to Irish pension funds. The changes in Finance Act 2005 permit the deduction of pension contributions by Irish individuals to pension plans based in other EU Member States. Individual pension schemes are subject to approval by the Irish tax authorities and must be operated by an Institution for Occupational Retirement Provision, within the meaning of the EU Pensions Directive and must be established in an EU Member State which has implemented the Directive in its national law. This amendment will enable Irish based employees and employers to select pension providers on a pan-EU basis. A further change permits migrant workers coming to Ireland from another EU Member States to continue making contributions to their home country pension scheme.

A final change in Finance Act 2005 is also necessitated by non-discrimination requirements. Payments between two Irish resident group companies (at least 51% directly or indirectly related via EEA companies) may be made without deduction of withholding tax. This exemption has now been extended to payments by an Irish resident company or by an Irish branch of an EEA company to a company resident and subject to tax in the EEA.

Italy - Implementation of the EU Interest/Royalty Directive

By means of a Decree issued on 27 May 2005, the Italian Government implemented the EU Interest/Royalty Directive with retrospective effect to 1 January 2004. Withholding taxes levied on interest and royalties paid until the date of entry into force of the Decree and which fall within the scope of the implemented Directive, shall be returned to the foreign payee by the Italian withholding agent. In order to recover the withholdings levied, they may be offset against any Income Taxes due (and also against certain other taxes such as VAT and Substitution Tax). Please note that the Decree takes effect from 1 January 2004 with reference to Interest/Royalty “accrued” and not to Interest/Royalty “paid” from that date. The Decree also provides that interest reclassified as dividends under the Italian thin cap provision is subject to the tax treatment of dividend and may benefit from dividend withholding tax if the EU’s Parent/Subsidiary Directive requirements are satisfied in the case at hand.

Luxembourg - Inbound dividends: Extension of availability of foreign tax credits

Article 115,15.4 of the Luxembourg Tax Law provided for a tax credit for dividends received by individuals from Luxembourg taxed companies. No tax credit was allowed for dividends received from foreign (non-Luxembourg) companies. Pursuant to the Verkooijen Case, Luxembourg law was adapted and the said tax credit is now applicable to all dividends paid by a taxable EU company. However, this modification was only applicable as from 2002. The Tribunal stated that, despite the wording of the adaptive law (which entered into force as from 2002), as article 115,15.a in its prior

wording was infringing EU Law, the tax credit granted by this disposition also has to be granted to the plaintiff in respect of dividends he received from a Swedish company in the year 2001. As a conclusion, adapting the law as from an ECJ decision is not sufficient and any taxpayer may introduce a claim against the old law as long as it is possible in its national framework. It is only in exceptional cases that the ECJ states its decision will not have a retroactive affect.

Netherlands - Cross-border loss relief: Marks and Spencer flavor in proposals for Dutch corporate income tax reform 2007

On 29 April 2005, the Dutch Ministry of Finance presented a memorandum outlining the reform of the Dutch Corporate Income Tax Act, which will be enacted from 1 January 2007. This reform is the result of successive developments having a direct impact on the Dutch competitive position within the EU -one of them being the pending Marks & Spencer case. Anticipating the outcome of that case, it is proposed by the Ministry that EU subsidiaries are allowed to be included in a Dutch fiscal unity. By including an EU subsidiary in a Dutch fiscal unity, the assets and liabilities of this subsidiary are attributed to the parent company of the fiscal unity. For Dutch tax purposes, this results in a situation comparable to that in which a Dutch entity performs activities in a Member State through a permanent establishment. Losses incurred by the EU subsidiary can be offset directly against Dutch profit, which is similar to the treatment of losses realized by a foreign permanent establishment. Since the Ministry of Finance feels that allowing EU subsidiaries to be included in Dutch fiscal unities without any restrictions could result in too many losses ending up in the Netherlands, additional restrictions are proposed. These relate to the fiscal unity regime on the one hand and to the possibility to offset losses of EU subsidiaries (and permanent establishments as well) on the other. One of the restrictions is that the offsetting of foreign losses will become a temporary facility. Eventually, all foreign losses offset against Dutch profits must be recaptured, at the latest when the EU subsidiary (being a member of the fiscal unity) ceases to exist.

Norway - Outbound dividends: High court follows the EFTA Court in the Fokus Bank case

The Frostating High Court gave its judgement in the Fokus Bank case in accordance with the opinion of the EFTA court. The question at hand was whether or not the Norwegian rules for taxation of outbound dividends were in accordance with the EEA treaty (article 40). The Norwegian system favoured Norwegian residents, as dividends paid out to Norwegian residents are de facto tax free, while tax was levied on dividends paid out to foreigners as withholding tax on dividends. While the case was pending before the High Court, the court decided to ask the EFTA court for its opinion on the infringement question. In its statement from 23 November 2004 the EFTA court declared that Norwegian dividend taxation was an infringement with the EEA treaty. Under the proceedings before the High Court, the Norwegian tax authorities agreed with the EFTA court but claimed that the EEA treaty could not override the clear wording of the tax law adopted by the Norwegian Parliament. This latter argument was however rejected by the court. It is expected that the tax authorities will appeal to the Norwegian Supreme Court for a final decision on this matter.

Portugal - Inbound dividends: dividend exemption for individuals expanded to foreign dividends

Since 2002, an individual residing in Portugal only needs to account for 50% of dividends received from Portuguese resident companies for personal income tax purposes. This rule aims to reduce the economic double taxation of profits. The 2005 State Budget has broadened the application of this rule by applying as per 1 January 2005 the same tax treatment to dividends received from EU companies in as far as these companies comply with the requirements of the EU Parent-Subsidiary Directive 90/435/EEC. As such, the Portuguese Government seems to have followed the recent Manninen case in which the ECJ ruled that Articles 56 EC and 58 EC preclude legislation whereby the entitlement of a person fully taxable in one Member State to a tax credit in relation to dividends paid to him by limited companies is excluded where those companies are not established in that Member State.

Sweden - Controlled Foreign Companies: CFC legislation ruled incompatible with EU law

Recent developments in Sweden comprise mainly a number of tax rulings regarding the Swedish CFC-legislation and its compatibility with EC law. Sweden's "new" 2004 CFC-provisions aim at taxing Swedish tax resident shareholders for shareholdings in low-taxed foreign entities. When the provisions are triggered the Swedish shareholder is taxed on its portion of the income of the foreign entity, computed according to Swedish tax provisions. For a corporate taxpayer the portion will be taxed at the corporate tax rate of 28%. The Swedish board for advance rulings ruled in a couple of rulings in early April 2005 that the CFC provisions were: a) in respect of a holding in a low taxed foreign company outside the EU, not in breach with either the relevant bilateral tax treaty or the EC treaty, and b) in respect of a low taxed holding in a foreign company within the EU, not in breach with the relevant bilateral tax treaty but indeed in breach of the EC treaty (Art. 43). It is likely that both rulings will be appealed to the Supreme Administrative Court and that the court will refer the issues to the ECJ. The board of advance rulings is for formal purposes not entitled to do that. There are a number of other rulings pending in Sweden including the issues of the availability of tax consolidation with foreign affiliates and deemed taxation upon corporate migration.

Sweden - Cross-border loss relief: Swedish court rules group contributions system incompatible with EU Law

On 30 May 2005 the Regional Administrative Court of Vänersborg gave its judgement in the case of Aktiebolaget Lindex v. Skatteverket (Case no. 652-04 and 439-05). Aktiebolaget Lindex is a publicly listed company and a tax resident in Sweden. Aktiebolaget Lindex is the parent company of Lindex GmbH, which is a German tax resident. During the years 2002 and 2003 Aktiebolaget Lindex paid group contributions to Lindex GmbH, but was not entitled to take a deduction for these payments according to the Swedish group contribution rules. In Sweden consolidated accounts are not recognized for tax purposes. However, under specific conditions Swedish tax law allows the shifting of income through group contributions. A company paying a group contribution is entitled to deduct this amount from its taxable income and the recipient of the contribution must include this in its taxable income. Therefore the losses of one company may be off set against profits of another company which is part of the same group. However, the group contribution system requires that the receiving company is a tax resident of Sweden. In the case at hand, Lindex Gmbh was a tax resident of Germany and therefore the Aktiebolaget Lindex was not allowed to deduct the group contribution payments. The Regional Administrative Court of Vänersborg ruled that a rule requiring a receiving subsidiary to be taxable in Sweden constitutes a restriction on the freedom of establishment since it creates an obstacle to Swedish resident companies from establishing companies in other Member States.

Switzerland - Abolition of withholding tax on dividends, interest and royalty payments (Swiss-EU Savings Agreement) - Interpretation of the Swiss tax authorities

On 1 July 2005 the Swiss-EU Savings Agreement enters into force, which is applicable between Switzerland and the current 25 EU member states (subject to transitional rules for certain countries). In recognition of Switzerland's cooperation on the taxation of savings income, the Agreement includes in article 15 measures equivalent to those found in the EU Parent-Subsidiary Directive and the Interest and Royalties Directive. Accordingly payments of dividends, interest and royalties between Swiss and EU resident companies may now qualify for full withholding tax relief. The most crucial conditions are a minimum ownership of 25% for a period of two years and the subjection of the companies to corporate tax in their respective country of residence (EU - Switzerland). The Swiss tax authorities have publicly announced some practical information on how they will interpret these requirements (official guidelines expected to follow shortly):

1) The two-year minimum holding period can be fulfilled post-distribution. For payments made prior to the expiration of the holding period, compliance with this requirement may be safeguarded through a tentative payment of the withholding tax at the reduced treaty rates, which can be then refunded upon expiration of the minimum holding period. With respect to EU countries which are

not treaty partners with Switzerland (Cyprus, Malta), the full 35% withholding tax should be paid in the first instance; and

2) The subject-to-tax clause is deemed to be fulfilled for Swiss companies that are subject to tax at least at federal level. Hence, companies with holding-, mixed- or domicile status are deemed to fulfill this requirement. However, companies enjoying full tax holiday (at federal and cantonal level) would not qualify. There is not yet a clear position with respect to companies enjoying a partial tax holiday. Loss-situations do not as such jeopardize compliance with this requirement. The above interpretation reflects only the Swiss approach (i.e. for payments out of Switzerland) and may not be binding for inflowing income. The respective interpretation of the various EU Member States is still pending. Cases of abuse or lacking sufficient substance may still be prevented from qualifying under the Agreement's basis. The relief from withholding tax on dividends according to the Agreement will be granted through the reporting (relief at source) procedure already applying for treaty countries since January 2005.

EU DIRECT TAX GROUP ACTIVITIES

EU Tax Commissioner Kovács welcomes EFRP / EUDTG reports on discriminatory tax treatment of foreign pension funds

On 21 April 2005, EU Tax Commissioner László Kovács received a delegation of the European Federation for Retirement Provision (EFRP) and PwC's EUDTG. The Commissioner warmly welcomed two reports jointly prepared by the EFRP and the EUDTG on discriminatory tax treatment of occupational pension funds. The delegation informed the Commissioner that the EFRP and EUDTG were also jointly preparing two formal complaints to the EC about discriminatory tax treatment of pension institutions regarding cross-border transfers of pension capital and payments of dividends and interest to foreign pension funds. The first report dealt with discriminatory tax treatment of cross-border transfers of pension capital in which the EFRP found that a number of Member States have legislation which may be in breach of the EC Treaty. The second report summarized the preliminary conclusions of research by the EUDTG and established how pension funds suffer from discriminatory treatment when making cross-border investments in bonds or shares. The preliminary conclusions of the report are that in a number of Member States local pension funds are granted more favourable tax treatment than foreign pension funds receiving similar income. Also, in a number of Member States interest and dividend payments to local pension funds are either not subjected to withholding tax or the local pension fund can benefit from a refund of the tax withheld. However, such exemptions or refund procedures are not available for pension funds established in another Member State. The result is that the source State taxes dividends and interest paid to foreign funds more heavily than dividends and interest paid to domestic funds. In the EFRP and EUDTG's views this different treatment is in breach of Article 56 of the EC Treaty. They therefore conclude that there is no justification for such different treatment. The final joint EFRP/EUDTG report, together with the formal complaints, will be presented to the Commission in June 2005, after which the text of the complaints will be made public.

ABOUT THE EUDTG

The EUDTG is one of PricewaterhouseCoopers' Thought Leadership Initiatives and embedded in the International Tax Services Network. The EUDTG is a pan-European network of EU tax law experts and provides assistance to organizations, companies and private persons to help them to fully benefit from their rights under EU law. The activities of the EUDTG include organizing tailor-made client conferences and seminars, performing EU tax due diligence on clients' tax positions, assisting clients with their (legal) actions against tax authorities and litigation before local courts and the ECJ. EUDTG client serving teams are in place in all 25 EU countries, most of the EFTA countries and Switzerland.

For further information regarding the contents of this newsletter or the EUDTG in general, please contact the EUDTG Secretariat through Marcel Jakobsen (email: marcel.jakobsen@nl.pwc.com; tel.: + 31 10 407 5688).

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