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ECJ CASES

Germany - Cross-border legal mergers: SEVIC Systems AG case (C-411/03)

SEVIC Systems AG (SEVIC) is a company with its seat in Neuwied, Germany. It concluded a merger agreement with Security Vision Concept SA (SVC) based in Luxembourg. Under the agreement all assets and liabilities of SVC were transferred to SEVIC and SVC was dissolved without being liquidated. As the German Restructuring Act only allows for mergers between companies with a seat in Germany, the application for registration of the merger in the trade register was rejected. According to a German Lower Court, it is unclear whether the provision is in breach of the freedom of establishment. The Court referred the question to the ECJ for a preliminary ruling. On 7 July 2005, the Advocate-General of the ECJ (A-G) concluded that the German provision restricts the freedom of establishment. The provision prevents German companies establishing or extending their presence in other Member States via cross-border merger as well as similarly inhibiting companies in other Member States access to the German market. In the opinion of the A-G the restriction cannot be justified. Even if the restriction could be justified, the German provision is disproportionate. In respect of the not yet enacted Cross-Border Mergers Directive, the A-G pointed out that the exercise of the freedom of establishment can not be made dependent on harmonization Directives (See PwC Newsalert 2005-003 for more details).

-- Caroline Naumburg and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

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Germany - Cross-border maintenance payments: Schempp case (C-403/03)

Mr. Schempp is a German citizen living in Germany, who made maintenance payments to his former spouse living in Austria, and who sought to deduct these payments from his taxable income. Such deduction is granted for payments to German residents. Deduction for payments to residents of EU and EEA countries is granted only if it can be proven that the payments are subject to tax in the recipient's state of residence. Since maintenance payments are not taxable in Austria, Mr. Schempp was denied this deduction by the German tax administration. The German Supreme Court referred the case to the ECJ for a preliminary ruling. In its judgment of 12 July 2005, the ECJ initially stated Mr. Schempp's situation had sufficient connection to Community law, since the denial of the deduction of the maintenance payments was a direct result of Mr. Schempp's former spouse exercising her treaty right to move to Austria. The ECJ then went on to say that there is no discrimination on grounds of nationality. 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 argument that the maintenance payments would also have remained untaxed if Mr. Schempp's former spouse had resided in Germany, since her income was below the tax-free amount, was dismissed by the ECJ on the grounds that the *non-taxable* character of the payments in Austria cannot not be compared with the (actual) *non-taxation* of these in Germany. 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 claimant party himself but his former spouse had made use of the right to move within the EU (See PwC Newsalert 2005-004 for more details).

-- Caroline Naumburg and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

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Germany - CFC legislation: Kolumbus Container Services BVBA case (C-298/05)

On 5 July 2005, a German Lower Tax Court referred the first case regarding German CFC rules to the ECJ. The key question is whether Germany may switch from the tax-exemption method for branch profits agreed in a double taxation treaty to a mere tax credit if the foreign branch income is subject to low taxation abroad and stems from certain "passive" sources. The plaintiff is a Belgian limited partnership with German resident partners. The activities of the partnership, among others, consisted of financing of subsidiaries and branches. The partnership's profits and assets were, under German domestic tax law, specifically assessed as foreign branch profits and assets of the German partners. In Belgium, the partnership was treated as a company and enjoyed the status of a Belgian Coordination Centre. According to the double tax treaty between Belgium and Germany, profits from and the net assets of a Belgian partnership are tax-exempt in Germany. Since the early 1990s, the International Tax Transactions Act provides, however, for a switch from the exemption method to the tax credit method in respect of certain passive branch profits. These provisions had been introduced explicitly to prevent a circumvention of the CFC rules applicable only to foreign subsidiaries. Doubting the compatibility of the named provisions with the freedom of establishment and the free movement of capital, the Lower Tax Court referred the case to the ECJ.

The outcome of this referral is much anticipated. As the above provisions serve to put foreign branches and partnerships on a par with foreign subsidiaries in terms of penalizing foreign investment in low tax countries, the referral raises, at least prima facie, high expectations on eliciting at the same time more about the ECJ's attitude towards the German CFC rules in their by far more prominent field of application, i.e. with respect to foreign subsidiaries. There is however a difference between the impact of the CFC rules on foreign subsidiaries and on branches/partnerships which is likely to become decisive from the EU law perspective: in the case of a foreign subsidiary with low-taxed passive income, the subsidiary is treated as transparent and thus worse than a comparable domestic subsidiary, for which no distinction is made between active and passive income. In contrast, where the CFC rules penalise a foreign branch or partnership with low-taxed passive income by replacing the exemption method with the tax credit method, the foreign branch is not treated worse than a domestic branch. This difference not only limits the possibility of drawing conclusions from this case for cases concerning foreign subsidiaries, but also rules out the possibility for the tax court to simply draw on the familiar pattern of a barrier to investment abroad proven and tested in numerous outbound cases already. According to the tax court, it cannot be excluded that the provisions in question infringe on the freedom of establishment by simply rendering difficult certain economic activity in a foreign branch or partnership. Although not explicitly put that way, the tax court may have identified a direct barrier in the fact that the provisions do not only *inhibit* but are expressly and exclusively *intended* to prevent such activity abroad. Whether the ECJ will follow this route remains to be seen. Another question the ECJ might consider, although not posed by the tax court, is whether Germany is permitted to exert investment control within the EU by penalising investments in Member States with a tax rate today of less than 25% (benchmark for low taxation) and leaving completely unaffected investments in Member States with a tax rate of 25% or more. It cannot be excluded, however, that the question in this case might also boil down to the rather general question whether treaty overrides are permitted under EU law at all.
-- Thomas Brink and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

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Hungary – Business taxes and VAT Directive: Lakép Kft et al Case (C-261/05)
In Hungary, a number of businesses have taken court action to establish that the Hungarian local business tax (LBT) contravenes Community law. On 29 April 2005, a Hungarian court referred questions to the ECJ for a preliminary ruling on: 1) what are the criteria, which allow a tax to be characterised as a tax having the nature of a turnover tax; 2) should a tax the taxable basis of which is the net turnover corresponding to sales made or to services provided, after deduction of the purchase price of the goods sold and the value of the services provided by third parties, and also of the material costs (or a certain proportion thereof), be regarded as having the nature of a turnover tax; 3) does Article 33 of the EU Directive mean that in the Member States only a single tax having the nature of a turnover tax may be maintained; and 4) in so far as two or more taxes having the nature of turnover taxes are maintained in a Member State after accession to the EU, is the assessment, with retroactive effect, of a tax - relating to a period before accession - contrary to

Article 33 of the Directive? The case resembles the already pending Italian IRAP case (See PwC Newsalert 2005-009 for more details).

-- Gabriella Erdos and Tamas Locsei, Hungary; gabriella.erdos@hu.pwc.com

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Netherlands - Free movement of capital between the EU and third countries: Van Hilten case (C-513/03)

Mrs. Van Hilten-Van der Heijden was a Dutch national who emigrated from the Netherlands to Belgium in 1988. She lived in Switzerland when she died in 1997. Since she was a Dutch national and had lived in the Netherlands less than ten years prior to her death, Mrs. Van Hilten was deemed to be a Dutch resident for Dutch inheritance tax purposes. As a result, her four heirs were liable to Dutch inheritance tax for their share in the inheritance, with a credit for the Swiss inheritance tax paid in accordance with the provisions of the Netherlands-Switzerland Inheritance Tax Convention. A Dutch Lower Court opined that the deemed residence rule for inheritance tax purposes unlawfully restricted the free movement of capital between the Netherlands and Switzerland, and referred the matter to the ECJ for a preliminary ruling. On 30 June 2005, the A-G concluded that only the distribution of the estate of Mrs. Van Hilten is to be considered a capital movement within the meaning of Article 56(1) of the EC Treaty and not her emigration to Belgium and Switzerland. Since the distribution of the estate would not have been taxed more favourably in the Netherlands if and when Mrs. Van Hilten had been a Dutch resident at the time of her death, there is no restriction of the free movement of capital between the Netherlands and Switzerland. The Dutch "deemed residence" rule does not restrict the right of EU citizens to move and reside freely within the territory of the EU. In particular, the A-G finds that this right does not include the right to be taxed more favourably than nationals staying at home. The A-G considered that the use of nationality as a criterion for determining fiscal jurisdiction is not a discrimination on grounds of nationality within the meaning of Article 12, of the EC Treaty, referring to international practice and the Commentaries on the OECD Model Convention (See PwC Newsalert 2005-001 for more details).

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Netherlands - Most Favoured Nation doctrine: D. Case (C-376/03)

Mr. D. resides in Germany. As of 1 January 1998, 10% of his wealth consisted of real property situated in the Netherlands, while the remainder was held in Germany. Mr. D was liable to Dutch wealth tax as a non-resident taxpayer. Whereas resident taxpayers are entitled to an allowance applied to their net worldwide assets, non-resident taxpayers are not entitled to an allowance in the Netherlands. Moreover, had Mr. D. been a Belgian resident, he would have been granted the allowance under the Belgium-Netherlands Tax Treaty. Mr. D. nevertheless applied for the allowance, which was rejected by the Dutch tax inspector. A Dutch Lower Court referred the matter to the ECJ, which on 5 July 2005 considered that a taxpayer who holds only a minor part of his wealth in a Member State other than the one where he is resident, is not, as a rule, in a situation comparable to that of residents of that other Member State. The refusal to grant him the allowance to which residents are entitled does not discriminate against him. The ECJ also dismissed Mr. D.'s argument based on the Most Favoured Nation treatment. The ECJ ruled that the Netherlands is allowed to treat German residents less favourably than Belgian residents if this disadvantageous treatment results from a bilateral tax treaty (See PwC Newsalert 2005-002 for more details).

-- Sjoerd Douma, The Netherlands; sjoerd.douma@nl.pwc.com

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Netherlands - Capital Tax Directive: Senior Engineering Investments B.V. case (C-494/03)
Senior Engineering Investments B.V. (SEI) is a private limited liability company incorporated under Dutch law and established in the Netherlands, whose shares are held by a U.K.-based company (the parent company). SEI is the sole shareholder of a company established in Germany (the sub-subsidiary). In 1997 the parent company made a capital contribution to the share premium account of the sub-subsidiary. The Dutch tax authorities regarded this transaction as an indirect capital contribution to SEI and therefore capital duty was due by SEI. It was unclear to the Dutch Supreme Court whether the levy of capital duty on SEI was compatible with Council Directive 69/335 EEC (on indirect taxes on the raising of capital). The Court subsequently referred the case to the ECJ for a preliminary ruling. On 14 July 2005, the A-G opined that the capital contribution to the sub-subsidiary should not be regarded as two separate transactions through SEI into the sub-subsidiary but as a single transaction. The fact that SEI indirectly benefits from the capital contribution to the sub-subsidiary is generally not a taxable event. The A-G is of the view that only Germany has the right to tax the capital contribution to the sub-subsidiary, as the latter is the direct recipient of the contribution (See PwC Newsalert 2005-006 for more details).
-- Cees Peters and Frank Engelen, The Netherlands; frank.engelen@nl.pwc.com

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Sweden - Capital gains taxation for non-resident individuals: Bouanich case (C-265/04)
Mrs. Bouanich is a French resident who held shares in a Swedish company that repurchased shares from its shareholders, which in Sweden triggers a capital gains tax of 30%. Swedish residents are taxed on the gain after deduction of base cost and expenses. The non-resident's gain is treated as a dividend and subject to a 30% withholding tax, without deduction of base cost and expenses. The double tax treaty between Sweden and France provides for a reduced rate of withholding tax on dividends of 15% and this rate was applied to the gross selling price. Mrs. Bouanich appealed against this and asked for a reduction to zero and a repayment of the tax on the par value of the shares. A Swedish Lower Court referred the case to the ECJ for a preliminary ruling. On 14 July 2005, the A-G concluded that the different treatment under Swedish national law of residents and non-residents in respect of the taxation of capital gains is an unjustifiable restriction of the free movement of capital. The A-G also asserted that the provisions of a tax treaty have to be considered when deciding whether a treatment is allowed under the EC Treaty or not. It has to be analysed in the individual case if the treaty has the effect that the disadvantage suffered by non-resident compared to resident shareholders is eliminated. The Swedish court should assess if this applies in this particular situation. Insofar as the treaty does not result in equal treatment, it must not be applied (See PwC Newsalert 2005-005 for more details).
-- Caroline Naumburg, United Kingdom/Germany; caroline.naumburg@de.pwc.com

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United Kingdom - CFC legislation and Dividend Group Litigation Order (C-201/05)
On 18 March 2005, the High Court of Justice (England and Wales) referred several questions on UK CFC-legislation and taxation of overseas dividends to the ECJ, The Test Claimants in the CFC and Dividend Group Litigation Order (GLO). At this time, Cadbury Schweppes (C-196/04) was already pending with the ECJ regarding UK CFC-legislation. However, that case does not cover all aspects of the legislation that are important for a complete decision on the topic. Hence, the GLO was necessary to clarify remaining issues. Also, Cadbury Schweppes deals solely with CFC-legislation and does not include the basic question of UK treatment of foreign dividends. Moreover, the GLO is a UK common law multi-party action for restitution/damages, whereas the Cadbury Schweppes case is a referral from the UK's Special Commissioners tax tribunal. As the GLO deals with restitution/damages rather than with reclaim of corporation tax, it is necessary to clarify the requirements needed under Community law for a taxpayer to make a claim under such action.

The first issue is: is it contrary to the freedom of establishment (Art. 43 EC) and the free movement of capital (Art. 56 EC) that dividends received by UK resident companies are exempt from corporation tax, whereas dividends received from a non-UK resident company are not? In particular, is it contrary to said freedoms to tax such dividends where the company non-resident is a CFC and the UK taxes the dividends after giving relief for withholding tax and underlying tax?

The Court also asked if it is contrary to the EC treaty that the UK imposes tax on CFC profits before these are distributed and imposes administrative obligations on the controlling company in respect of this legislation (the latter is equally subject to decision in the Vodafone 2 case).

Unlike Cadbury Schweppes, the GLO includes cases concerning companies in third states. Hence, the Court enquired whether it makes a difference if the controlled non-resident companies were resident outside the EU. In addition, if the rules being challenged were in place as of December 31, 1993 but amended after that date and the amended rules are considered in breach of Art. 56 EC, whether the rules are protected by the standstill clause in Art. 57 EC, which allows Member States to keep in place restrictions on the free movement of capital as regards third states that existed as of 31 December 1993?

If these rules are contrary to the freedoms, the Court asked how the taxpayers' claims for repayment, restitution and or compensation in respect of losses, reliefs and expenses should be treated. Are these: claims for repayment of sums unduly levied, for compensation or damages or for an amount representing a benefit unduly denied? Where the claims are for damages or for a benefit unduly denied, the question arises as to which criteria set out by the ECJ in Brasserie du Pecheur (C-46/93) and Factortame (C-48/93), have to be met for the claimants to be successful. For example, was the breach of Community law sufficiently serious, was it excusable and was there a direct causal link between the breach and the losses suffered by the claimants?
-- Caroline Naumburg and Peter Cussons, United Kingdom; peter.cussons@uk.pwc.com

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United Kingdom - CFC legislation: Vodafone 2 v HRMC case (SpC 479)
The UK's Her Majesty's Revenue and Customs (HMRC) issued an enquiry notice to Vodafone 2. and sent a separate letter to the Vodafone group referring to the enquiry notice and containing a number of questions concerning the CFC status of one of Vodafone's subsidiaries for which it had claimed that the motive test exemption applied. Vodafone appealed against the notice on the grounds that since the UK CFC provisions contravene the freedom of establishment and free movement of capital, HMRC could not validly require it to produce documents or provide information in relation to any part of the enquiry that related to compliance with the CFC legislation. Vodafone 2 subsequently made an application for a closure notice but HMRC argued that the letter was not a notice but an informal request for information. The Special Commissioners agreed that the letter was not a notice, and that there could therefore be no appeal. The Special Commissioners are obliged to give a direction that HMRC give a closure notice, unless they are satisfied that HMRC have reasonable grounds for not giving a closure notice. Counsel for the taxpayer contended that HMRC's enquiry was not reasonable, as its only purpose was the testing of the claim that the subsidiary was entitled to the CFC motive test exemption, and that the CFC legislation is incompatible with EC law. However, he accepted that the incompatibility of the CFC legislation with the EC Treaty is not an "acte claire", and therefore requested that the Special Commissioners refer the matter to the ECJ. The Special Commissioners concluded that the circumstances in this case give rise to questions of interpretation of the EC Treaty, which go beyond the questions referred in Cadbury Schweppes and the CFC and Dividend Group Litigation. They therefore directed that the case be referred to the ECJ. HMRC are however seeking an expedited appeal hearing to quash the referral (See PwC Newsalert 2005-008 for more details).
-- Peter Cussons, United Kingdom, peter.cussons@uk.pwc.com

NATIONAL DEVELOPMENTS

Austria - Most Favoured Nation doctrine (RV/1799-W/03)

On 23 June 2005 (i.e. a few days before the ECJ released its decision in the D-case), a Lower Court decided upon a claim of a taxpayer to reduce withholding tax on royalties to its Dutch parent company from 10% to nil on the basis of a tax treaty which Austria had concluded with a third country. While royalties paid to a German parent company are tax exempt, royalties to a Dutch parent company are subject to 10% WHT. However, since the taxpayer could not provide evidence that the recipient incurred a loss in the respective year, the Senate found that the withholding tax can be fully credited against Dutch taxes and that therefore no discrimination can be constituted. A preliminary ECJ ruling was not considered necessary and the claim was rejected. The Court refrained from making any statement as to whether the mere cash flow disadvantage - which the taxpayer suffers irrespectively of whether or not the Austrian withholding tax will be credited in the Netherlands - constitutes discrimination.

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France – Cross-border loss relief / French group taxation case (04PA01300)

Under strict conditions, French entities subject to corporate income tax may elect to create a tax group. However, the tax consolidation regime includes only French subsidiaries. Moreover, the parent company must own at least 95% of its subsidiaries, either directly or indirectly, through companies that are also a member of the tax group. A Lower Court – without referring to the ECJ for a preliminary ruling – decided on 24 June 2005 that the interposition of a company located in the Netherlands and not subject to corporate tax in France, between the French parent company and other French subsidiaries, prevented the parent company from including such affiliates in the tax consolidation. The Court considered that such a restriction was not incompatible with the freedom of establishment set out in Article 43 of the EC Treaty. It held that the condition that all the members of the tax group must be subject to French corporate income tax was justified by the coherence of the tax consolidation regime, e.g. that the companies be subject to the same computation rules and that the profits be aggregated into the total income of the parent. The Court also held that the limitation at stake was compatible with the non-discrimination principle of the France-Netherlands tax treaty.

-- Franck Le Mentec and Michel Taly, France; michel.taly@fr.landwellglobal.com

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Germany – Deductibility of interest relating to foreign subsidiaries

After the ECJ decision in the Bosal Holding case in 2003, the position on deductibility of shareholders' expenses seemed clear. Such expenses must, according to the EU Parent/Subsidiary Directive interpreted in the light of the freedom of establishment, be deductible regardless of whether the profits of the subsidiary are taxed in the Member State of the parent company or not. Until tax year 1998, expenses having immediate economic connection with tax exempt foreign dividends could not be deducted in Germany. For 1999 through 2001, this rule was substituted by a 5% add-back on exempt foreign dividends. Dividends from a German resident company were not affected by any of these restrictions, as they were - technically - taxable under the former German imputation system. As of tax year 2002, both foreign and domestic dividends are tax exempt. Nonetheless, the 5% add-back continued to apply to foreign dividends, whereas upon receipt of domestic dividends, actual expenses having immediate economic connection with the investment were non-deductible. As of 2004, foreign and domestic dividends are subject to the same add-back.

Keller Holding (C-471/04) received intermediate foreign tax-exempt dividends in 1994 and 1995 and was denied deduction for shareholder's expenses, against which it appealed. The German

Supreme Tax Court held that the expenses were non-deductible, since the dividends were tax exempt in Germany - a situation similar to that in Bosal Holding. Dividends from a resident company were taxed, but the technique of the imputation system compensated for the initial taxation, with the result that dividends were economically exempt once redistributed. Therefore, the non-deductibility of expenses only for dividends from non-resident companies is questionable.

The German tax authorities did not share this view and two other cases are now pending with the Supreme Court on similar issues. The cases regard the 5% add-back as it applied from either 1999 through 2001 or from 2002 through 2003. In both cases the Lower tax Court of Hamburg held that the Parent-Subsidiary Directive, interpreted in the light of the freedom of establishment, prohibits a differential treatment as the 5% add-back. The 5% add-back in 2002 on foreign dividends is also pending with various Lower Tax Courts. As of 2004, there is one remaining debatable point: within a German fiscal unit ("Organschaft"), profit is pooled rather than distributed and so the 5% add-back does not apply. An Organschaft is only possible between German resident companies, so that profits from non-resident subsidiaries are subject to a disadvantageous treatment.
-- Caroline Naumburg and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

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Ireland – Guidance Notes EU Savings Directive
In July 2005, after close liaison with the Irish Financial Services Industry, the Irish Revenue Authorities issued Guidance Notes for paying agents in relation to the operation of the Council Directive 2003/48/EC (EU Savings Directive), as transposed into national law in Ireland. One of the key issues in an EU context that is dealt with by these Guidelines is the procedure for reporting details to the Irish Revenue of interest payments made to certain non-resident customers to enable the Irish Revenue to fulfil its reporting obligations to the Revenue Authorities in other Member States.
-- Susan Kilty and Mary Walsh, Ireland; mary.walsh@ie.pwc.com

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The Netherlands – A-G opinion on different taxation of domestic and foreign dividends and free movement of capital (Case 40 037)
A Dutch investment fund was denied a refund of tax withheld on dividends from Portuguese and German investments (in the years concerned, no double tax treaty was in force between the Netherlands and Portugal, and the double tax treaty between the Netherlands and Germany did not provide for a tax credit in respect of dividends paid by a German resident company to a Dutch resident shareholder). In addition, the investment fund was also denied a refund of tax withheld on dividends received from investments in qualifying treaty countries, in so far as its shareholders were resident outside of the Netherlands. The Dutch Supreme Court has to decide on the compatibility of the national rule with the free movement of capital. In his opinion handed down on 3 May 2005, the A-G first considers that, as a general rule, the free movement of capital requires that EU dividends receive no less advantageous tax treatment than domestic dividends and, therefore, a Dutch investment fund is, in principle, entitled to a refund of tax withheld on EU dividends irrespective of the terms of the double tax treaty with the Member State concerned, if any, and the place of residence of its shareholders, as these are not relevant for a refund of tax withheld on domestic dividends either. Essentially adopting a "look-through" approach, the A-G concludes that the refund of foreign tax withheld on EU dividends is limited by the amount of Dutch (withholding) tax due by the shareholders if and when such dividends are distributed by the Dutch investment fund as required by law. As regards the refund of foreign tax withheld on dividends received from third countries, the A-G doubts whether the free movement of capital between Member States and third countries requires that the above principles must equally be applied to such dividends, and he

therefore advises the Supreme Court to refer the matter to the ECJ for a preliminary ruling (See PwC Newsalert 2005-007 for more details).
-- Irma van Scheijndel and Frank Engelen, The Netherlands; frank.engelen@nl.pwc.com

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The Netherlands – Supreme Court judgment on EU Directive on indirect taxes on the raising of capital (C-39.953)

NV, having its statutory seat in the Netherlands Antilles, transferred its real seat from the Netherlands Antilles to the Netherlands in 1978. Afterterwards, NV had its real seat in the Netherlands Antilles for a couple of years and in 1996, NV retransferred its real seat to the Netherlands. According to Dutch law, which is based on Council Directive 69/335 EEC (on indirect taxes on the raising of capital), the transfer of the real seat from a non-EU country to the Netherlands is a taxable event for the purpose of capital duty. NV appealed against the tax assessment of 1996, arguing, among others, that the national provision is not compatible with the free movement of capital between EU Member States and third countries (Art. 56 EC). The Dutch Supreme Court established that the national provision as applied to NV was perfectly in line with the corresponding provision of the Directive. Since the Directive is based on the EC Treaty, the Directive is the guideline for determining whether a national law is compatible with Community law. The Court refused to refer the case to the ECJ, in particular, the question whether the Directive itself is compatible with the free movement of capital between EU Member States and third countries. The Court argued that, since the national provision / Directive already existed on 31 December 1993, Art. 57 EC grandfathers their (possible) restrictions on the free movement of capital between EU Member States and third countries. In its judgment, the Supreme Court did not pay attention to the A-G's opinion that the transfer of the real seat in itself should be covered by the freedom of establishment, rather than the free movement of capital.
-- Irma van Scheijndel, The Netherlands; irma.van.scheijndel@nl.pwc.com

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The Netherlands - Supreme Court judgment on the criterion of nationality for allocating fiscal jurisdiction (40.418)

According to the (former) Dutch-Belgian tax treaty, under certain conditions, the Netherlands is entitled to levy income tax on the capital gain realised upon alienation of shares in a Dutch resident company which constitute a substantial interest. The conditions are as follows: the shares are alienated by an individual within a period of 5 years as from his/her emigration from the Netherlands to Belgium and that person is a Dutch national. The taxpayer appealed against the assessment. In its judgment on 12 August 2005, the Supreme Court did not admit the taxpayer's argument that the criterion of nationality, as used in the tax treaty provision, is a prohibited discrimination under Community law and referred to the ECJ decision on Gilly (Case-336/96). In the Gilly decision the ECJ held that in absence of any unifying or harmonizing measures, it is the competence of the contracting parties to define the criteria for allocating tax jurisdiction with a view to eliminating double taxation. In addition, the ECJ held the criterion of nationality in accordance with the international tax practice.
-- Irma van Scheijndel, The Netherlands; irma.van.scheijndel@nl.pwc.com

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Sweden – Lower Court judgment on tax deferral upon exchange of shares (case 5189-03)

Under now abolished Swedish law, provided certain conditions are met, a resident taxpayer may defer taxation of capital gains on exchange of shares. Individuals moving abroad are subject to tax on capital gains derived from the exchange of shares upon emigration. In its judgment of 15 June 2005, a Lower Court confirmed that the requirement of qualified Swedish tax residence for making

use of the tax deferral mechanism is in conflict with the freedoms of the EC Treaty. The current new provisions are not identical with the old tax deferral system but imply a possibility of roll-over-relief. There is still a requirement of qualified Swedish tax residence for applicability, and provisions on immediate taxation upon migration. It might seem likely that this judgment and the principles of Community law would preclude such Swedish taxing rights also under the new system but precedents are lacking.
-- Gunnar Andersson, Sweden; gunnar.andersson@se.pwc.com

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EU DEVELOPMENTS

EC takes action against several Member States over national implementation measures
On 15 July 2005, the European Commission sent a second formal warning to the Czech Republic, Greece, Ireland, Italy and Luxembourg for their failure to adopt and notify national implementing measures to the EU regarding the amended Parent Subsidiary Directive (2003/123/EC); Greece received another warning in respect of the amended Interest and Royalties Directive (2004/76/EC); and, lastly, the Czech Republic, Greece, Italy and Luxembourg received a yellow card from the Commission for their failure to adopt and notify implementing measures in connection with the amended Mutual Assistance Directive (2004/56/EC). While Ireland also received a warning in respect of the Mutual Assistance Directive, the position has now been remedied in Ireland with the signing into law of the required statutory instrument. Art. 226 of the EC Treaty stipulates that the Member States concerned now have 2 months to adapt their legislation if they wish to avoid any infringement proceedings before the ECJ. See for more details the EC's press release: IP/05/941
-- Mary Walsh, Ireland, and Bob van der Made, Belgium; bob.van.der.made@pwc.be

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Belgium: EC decides to refer Belgium to ECJ over Walloon inheritance and gift tax laws
On 14 July 2005, the EC announced that it has decided to refer Belgium to the ECJ over Walloon inheritance and gift tax laws, which discriminate against foreign charities and as such violate Community law. The Walloon laws in question provide for a reduction of inheritance and gift taxes but only for two types of organisations: (a) those that are resident in Belgium, and (b) those established in the EU Member State in which the person making the legacy or the gift effectively resided/resides or in which he had/has his place of work at the time of the taxable event, or in which he had previously effectively resided or had his place of work. The reduced tax rate, however, does not apply to legacies or gifts to organizations established in EU Member States in which the person making the legacy or the gift never worked or lived. In the opinion of the EC, the Walloon inheritance and gift tax laws contravene Articles 12, 43 and 48 of the EC Treaty, and the corresponding articles in the EEA Agreement, which prohibit discrimination on grounds of nationality, restrictions to freedom of establishment and discrimination between companies of a Member State and natural persons who are nationals of that Member State. Similar provisions in the Flemish and Brussels tax laws have already been amended after a warning of the EC to Belgium in 2002. It is noteworthy that the Belgian Income Tax Code, under certain conditions, exempts gifts from taxation, provided that the gifts are made to Belgian resident institutions recognised by the Belgian Minister of Finance. That provision is likely to be in conflict with Community law too.
-- Caroline Goemaere and Laurens Narraina, Belgium; laurens.narraina@pwc.be

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Finland: EC requests Finland to amend discriminatory rules on income tax deductions for resident individuals with foreign source income

The European Commission announced on 15 July 2005 that it had sent a formal request to Finland concerning rules on income tax deductions applying to resident individuals with foreign source income. Under some of the tax treaties that Finland has concluded with other EU or EEA Member States, the foreign source income of an individual resident in Finland may be exempt from tax in Finland, using the exemption-with-progression method. Pursuant to the Finnish domestic law, resident individuals are granted limited personal deductions only on a pro-rata basis. Following the ECJ's reasoning in the De Groot case (C-385/00), the Commission considers that the unavailability of full personal deductions may dissuade Finnish residents from pursuing occupational activities as migrant workers in another EU or EEA Member State, and hence - by not granting full personal deductions to resident individuals with foreign source income, which is exempt with progression in Finland - Finnish tax law is incompatible with the free movement of workers and self-employed persons. If Finland does not reply in a satisfactory way to the request within 2 months, the Commission may refer the matter to the ECJ.
-- Karin Svennas, Finland; karin.svennas@fi.pwc.com

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Spain: EC requests Spain to amend discriminatory tax laws
On 14 July 2005, the European Commission requested Spain to amend the following discriminatory direct tax provisions:

- The taxation of non-residents' employment-related income;
- The taxation of capital gains of non-residents on the sale of Spanish immovable property;
- Taxes on the raising of capital;
- The tax deductibility of costs for research, development and technological innovation.

If Spain does not adapt its laws within two months after receiving the formal notice from the EU, the Commission may decide to start infringement proceedings against it before the ECJ. See for more details the EC's press release: IP/05/933
-- Bob van der Made, Brussels/Belgium; bob.van.der.made@pwc.be

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Sweden: EC requests Sweden to amend discriminatory rules regarding tax relief on capital gains from sales of owner-occupied dwellings
In July 2005, the European Commission requested Sweden to make a number of changes in the legislation regarding tax relief on capital gains from sales on owner-occupied dwellings. According to Swedish law, a Swedish resident individual taxpayer can enjoy a deferred capital gains tax after selling an owner-occupied dwelling, given that he has acquired or intends to acquire a replacement dwelling that will serve as his future permanent abode within a certain time after the original dwelling is sold. Under these rules, both the sold dwelling and the replacement dwelling must be located within Sweden. It is the Commission's opinion that the legislation in question violates EC Treaty rules on the free movement of persons, as the rules mean that deferral is not granted in cases where either the original dwelling or the replacement dwelling is located outside of Sweden. The Commission believes that the legislation contravenes the free movement of capital, the free movement of workers and the freedom of establishment (Articles 18, 39, 43 and 56 in the EC Treaty) as well. If Sweden does not revert with a satisfying reply to the Commission's reasoned opinion within two months from mid July, the Commission may refer Sweden to the ECJ.
-- Harald Steinbrecher and David Sjöstrand, Sweden; gunnar.andersson@se.pwc.com

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 organising 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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