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ECJ CASES

Germany – ECJ hearing on non-profit organisations: Stauffer case (C-386/04)

On 14 July 2004, the German Supreme Court referred the Stauffer case to the ECJ. Stauffer is an Italian resident charitable non-profit making foundation supervised by an Italian authority. Stauffer derived rental income from German real estate in 1997 subject to German corporation tax. Stauffer appealed against this, as comparable non-profit German resident organisations are exempt from corporation tax, and claimed an infringement of the freedom of establishment, the freedom to provide services and the free movement of capital.

The ECJ hearing took place on 13 October 2005. Stauffer argued that it is covered by the freedom of establishment. Stauffer added that it must also be acknowledged that it renders services that fall within the scope of the freedom to provide services, and that in any case, the investment is covered by the free movement of capital. Stauffer claimed that it is being discriminated against, as the requirement of German residency for tax exemption is likely to adversely affect companies seated in other Member States.

The German tax authorities argued inter alia that non-profit making companies are not covered by the freedom of establishment, Art 48 (2) EC. The term "profit making" is not fulfilled merely due to market participation, but postulates the deriving of positive income. Art. 48 (2) EC enables prevention of the competition distortion that might occur should non-profit organisations compete with regular companies. In addition, there is no discrimination: the tax exemption of resident charitable foundations is compensated by relief of state finances. Foreign organisations are generally concentrated on foreign beneficiaries and so do not relieve state finances. The German Government stated that the rule is not subject to review by the fundamental freedoms, as it constitutes a social privilege and cannot be exported without sufficient link between the privileged and the relevant state. Further, there is a coherence of the system due to the strict correlation between tax exemption and the substitution for tax in form of charitable work by German resident foundations. All other governments but the Italian Government were of the opinion that Stauffer cannot make use of the fundamental freedoms. The Italian Government argued that all three freedoms were applicable.

The European Commission held that not the freedom of establishment but the free movement of capital is concerned here due to the investment in German real estate. As Stauffer is treated less favourably than comparable German resident foundations, the free movement of capital is restricted. However, this restriction cannot be justified, as there is no objective difference between the situations, the tax authorities can gather any required information using the EU Mutual Assistance Directive (77/799/EEC), fiscal control can be achieved by less restrictive measures and the double tax treaties between Germany and France and the United States that grant advantages to charitable organisations further show that the German legislator indeed considers activities outside Germany as being inherent to the system.

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

Germany - Referral to ECJ on cross-border joint filing for spouses: Meindl (C-329/05)

Mr. Meindl, an Austrian citizen resident in Germany, derived income of DEM 132,422 in Germany in 1997. His Austrian resident spouse received an Austrian tax-exempt maternity allowance of DEM 26,995 from Austria. The spouses applied for joint filing in Germany to benefit from the split tax rate. This was rejected as joint filing where one spouse is non-resident requires that calculated according to German law, at least 90 % of the joint income is subject to German tax or the income not subject to German tax does not exceed DEM 24,000.

The German Supreme Court held that German law only exempts German and not foreign maternity payments, i.e. the Austrian payments were considered when calculating the total income. As these were not subject to German tax, the limits for joint filing were exceeded. The Court cited the Geschwind case (C-391/97), in which the ECJ approved the German limits for joint filing: a host state does not infringe EU law by denying joint filing unless there is insufficient home state income to account for personal/family circumstances. If the home state income exceeds DEM 24,000, it is assumed that this state can consider such circumstances. However, the Court thought this debatable where income is tax exempt in the home state: the taxpayer is on the one hand in no different position if a spouse derives tax-exempt income in the home state than when he derives taxable income exceeding the basic tax-free allowance. In both cases, the spouse's minimum subsistence amount is not taxed. On the other hand, the ECJ stated in the Wallentin case (C-268/03) that the denial of a basic tax-free allowance in the host state is discriminatory if income in the home state is outside the scope of taxation – then the host state must account for personal/family circumstances. The Court held that after the Wallentin case, it is questionable if discrimination is eliminated only if the home state exempts the minimum subsistence amount by basic tax-free allowance or if tax-exempt benefits are sufficient to secure the minimum subsistence amount, and referred the case to the ECJ.

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Germany – Referral to ECJ on most favoured nation treatment under GATS: Rizeni Letoveho Provozu (C-335/05)

A Czech company, Rizeni Letoveho Provozu, carried out services in Germany subsequent to the Czech Republic's accession to the WTO in 1995 but before its accession to the EU in 2004. The company applied for a VAT-refund in Germany, which was denied, as the German rule corresponds to the wording of Art. 2 (2) of the thirteenth VAT Directive (86/560/EEC), which enables EU Member States to deny VAT-refunds towards third states, where these do not grant corresponding refunds in return, i.e. reciprocal treatment. As the Czech Republic did not grant VAT refunds to German companies, Germany did not feel obliged to refund Czech companies.

A German Lower Court doubted, even though that the German rule corresponds to the wording of Art. 2 (2) of this Directive, if reciprocity regarding VAT-refunds can be required in respect of third states that are WTO members and referred to Art. 2 (1) of the General Agreements on Trade in Services (GATS):

"With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country."

The Court asked whether Art. 2 (2) of the EU Directive must be interpreted in the light of Art 2 (1) GATS, i.e. whether the reciprocity requirement can really be applied to WTO states, as EU Member States do not require such reciprocity among themselves. GATS is an agreement between nations,

which indeed only binds the contracting states and from which individuals can normally not deduce rights. However, the EU itself is party to the WTO, which makes the international agreement binding for organs of the EU as well as for its Member States (Art. 300 (7) EC). The Court therefore held it possible that secondary EU law has to be interpreted so as to conform to WTO law, in which case the VAT-refund had to be granted to the Czech Republic without reciprocity, since this is the case between EU Member States. GATS further contains the possibility to exclude areas from the most favoured nation clause under certain circumstances but this possibility was not used in respect of the thirteenth VAT Directive.

The difference to the negative judgment by the ECJ in the D case (C-376/03) in respect of most favoured nation treatment is that GATS contains a specific most favoured nation clause. Should the ECJ affirm that secondary EU law has to be interpreted in accordance with GATS principles, this could have an impact on direct tax in so far as secondary EU law deals with direct taxation on services, e.g. the EU Interest- and Royalty Directive.
-- Caroline Naumburg and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Italy – A-G opinion on State aid to Italian banks for merger transactions (C-66/02 and C-148/04)

The Italian Law nr 461/1998 (the so-called "Legge Ciampi") introduced a tax relief in order to facilitate the restructuring of the Italian banking system by way of mergers between banks and the transfer between banks of various equity assets. The tax relief mainly consists of the reduction of the income tax rate (IRPEG) from 37/36 % to 12,5 % for the banks that execute a merger or a similar restructuring transaction. The same provisions allow tax neutrality for transfer of various equity assets. Italian banks utilised the above-mentioned facilitation from 1998 to 2000.

On 11 December 2001, the European Commission adopted the judgement 2002/581/EC, which stipulated that the Legge Ciampi constituted State aid which was incompatible with EU law and it requested that the Italian Government suppress the regulations and recover from the beneficiaries the aid granted, including interest. The Italian Government appealed for a cancellation of the EC judgement before the ECJ.

On 8 September 2005, in Case C-66/02, the A-G confirmed that the tax facilitation granted to the Italian banks by Law n. 461/1998 constituted State aid, which was incompatible with EU law and affirmed the necessity to proceed to the recovery of the amounts from the final beneficiaries. On the same day, in a separate case, Case C-148/04, the same A-G affirmed the incompatibility of the State aid with EU law. In this case, the Italian Bank Unicredito S.p.A. had asked the ECJ through a Lower Court to verify the validity of the Commission's judgement (2002/581/EC) in C-66/02.

If the ECJ follows the conclusions of the A-G, the banks that benefited from the tax relief through merger transaction or by transfer of various equity assets must pay back the tax benefits received.
-- Claudio Valz, Italy; claudio.valz@studiopirola.com

Netherlands - ECJ judgment on tax treatment of contributions to national security schemes: Blanckaert case (C-512/03)

Mr Blanckaert is a Belgian resident and derives less than 90% of his worldwide income in the Netherlands. The only taxable income he received was income from immovable property, which is subject to income tax in the Netherlands as income from savings and investments. Mr Blanckaert is not insured under the Dutch social security system because he does not derive income from employment in the Netherlands. Upon appeal by Mr Blanckaert against the income tax assessment 2001, a Dutch Lower Court requested a preliminary ruling from the ECJ on 14 December 2003 on a number of questions, the most relevant of which was whether it is compatible with EU law that a non-resident/non-insured/non-contributing taxpayer is not entitled to a levy rebate for national insurance schemes, whereas a resident/insured/non-contributing taxpayer is entitled to that rebate, taking into account that both taxpayers actually do not pay contributions to those schemes. The A-G opined in favour of the Dutch regulations on 12 May 2005.

In its judgment of 8 September 2005, the ECJ first established that investments in immovable property in Member States by non-residents qualify as capital movements under Art. 56 EC. The ECJ then held that the criterion chosen by the Dutch legislator – only insured persons are entitled to a levy rebate for social security schemes – favours residents as under that system non-insured taxpayers are more often than not non-residents. Such legislation might deter non-residents from investing in immovable property in the Netherlands and is therefore capable of hindering the free movement of capital as it is laid down in Art. 56 EC. Art. 58 EC, however, permits unequal tax treatment of taxpayers who are not in the same situation with regard of their place of residence. That exception is only accepted if the difference in treatment applies to situations, which are not objectively comparable or are justified by overriding reasons of general interest. The ECJ ruled that there is an objective difference between the situation of a non-resident such as Mr Blanckaert and that of a resident who, in the same way as Mr Blanckaert, derives in the Netherlands only taxable income from savings and investments. As the grant of rebates is directly and exclusively linked to insured persons under the national security schemes, both residents and non-residents who are insured under these schemes are entitled to the rebates, whereas residents and non-residents who are not insured under these schemes, are not entitled to the rebates. Non-insured/non-residents would always automatically be entitled to a tax credit, whereas insured residents can only apply for a credit in the exceptional situation that the rebates exceed the contributions. Moreover, the ECJ confirmed that the Dutch provisions under decision are consistent with Council Regulation 1408/71/EC.

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Netherlands – Referral to ECJ on withholding tax on outbound dividends (C-379/05)

X S.G.P.S., resident of Portugal for tax purposes, owns 14% of the shares in D B.V., resident of the Netherlands for tax purposes. In 2002 D B.V. distributed dividends to X S.G.P.S., which were subject to 25% Dutch dividend withholding tax. X S.G.P.S. claimed an exemption from Dutch dividend withholding tax with respect to the dividend received from D B.V., arguing that the Dutch levy is in breach of EU law.

The Dutch Dividend Withholding Tax Act (Wet op de dividendbelasting 1965) provides for two exemptions in parent-subsidiary relations. The first exemption applies to dividend distributions by Dutch companies to other Dutch companies, to which, for Dutch corporate income tax purposes, the participation exemption applies. The second applies to cross-border dividends, which are covered

by the Parent-Subsidiary Directive. Since the interest X S.G.P.S. held in D B.V. was less than 25%, the Directive did not apply. The internal exemption did not apply either, since X S.G.P.S. was a resident of Portugal and the shares in D B.V. could not be attributed to a Dutch permanent establishment of X S.G.P.S. in the Netherlands.

On 21 September 2005, a Dutch Lower Court opined that the internal exemption restricts the free movement of capital, since it makes a distinction between resident taxpayers and non-resident taxpayers. However, it has to be examined whether this distinctive tax measure can be justified under Art. 58 EC. According to the Court, it is questionable whether the ECJ's restrictive interpretation of Art. 58 EC in the Lenz (C-315/02) and Manninen (C-319/02) cases, concerning inbound dividends, is also valid in the present case, which concerns outbound dividends. The present case concerns a different tax treatment of shareholders, which are tax residents of the Netherlands on the one hand and shareholders, which are not tax residents of the Netherlands on the other hand. The internal exemption has administrative simplification as its purpose: avoidance of the refund procedure, which would otherwise be necessary as the dividends are exempt from corporate income tax. According to the Court, such an administrative simplification is not applicable with regard to non-resident shareholders, as they are not liable to Dutch corporate income tax. Therefore, the Court fails to see why non-resident shareholders are arbitrarily discriminated against, in particular in situations such as X S.G.P.S., in which a credit for the foreign dividend withholding tax is available for the shareholder. The Court is also of the opinion that the differential treatment of resident and non-resident shareholders at hand can be justified under Article 58 EC by the need to safeguard the cohesion of the Dutch tax system. However, the Fokus Bank judgement of the EFTA Court (E-1/04) leads to reasonable doubt about the correctness of the Court's analysis, which has therefore referred the case to the ECJ for a preliminary ruling.
-- Pieter van der Vegt, Netherlands; pieter.van.der.vegt@nl.pwc.com

UK – The Cadbury Schweppes Plc. CFC case (C-196/04) is listed for ECJ hearing on 13 December 2005

NATIONAL DEVELOPMENTS

Germany – Federal Tax Court judgment: Lease payments and the Eurowings decision (I R 21/04)

On 15 July 2005, the German Federal Tax Court decided that section 8 no. 7 of the German Trade Tax Act, according to which 50% of any lease payments (except for real estate) are non-deductible for trade tax purposes unless the corresponding lease income is subject to German trade tax in the hands of the lessor, is compatible with EU law. Previously, in the Eurowings case (C-294/97), the ECJ had ruled that the freedom to provide services precludes legislation such as the above provision. In the Eurowings case, lease payments for an aircraft to an Irish limited company as lessor were captured by this 50% add-back whereas they would have been fully deductible had this lessor been resident in Germany and thus subject to trade tax.

The apparent contradiction with the ECJ's Eurowings ruling disappears when one looks at the facts of the case. A German resident company had leased an asset from its German resident individual shareholder. The 50% add-back applied as the lease income represented private income not subject to trade tax in the hands of the lessor. Not surprisingly the Federal Tax Court rejected any potential EU argument based on the fact that the lease transaction was purely domestic and thus outside the freedoms in the EC treaty. Nonetheless, the decision contains some important remarks on the application of the Eurowings decision. The Court made very clear that the 50% add-back would not have been incompatible with EU law even if the lessor had been resident in another Member State, as the lease income represented private income of the lessor, which is never subject to trade tax. An argument based on the ECJ judgment in Eurowings thus requires that the foreign lessor would be subject to trade tax if he were resident in Germany. Where the lessor's liability to trade tax is already negated for other reasons, lease payments to resident and non-resident lessors are treated equally. This specification may be relevant for cases where assets are leased from lessors in another Member State and where the lessee relies on a decree of the Federal Ministry of Finance from 2000, which still today constitutes the only official reaction to the Eurowings decision. This decree declares the add-back provision non-applicable in all cases where the lessor is resident in a Member State of the EU, the EEA or even in a treaty country. By the current decision, the Court makes clear that it would not follow this generous decree where the lessor is exempt from German trade tax also for other reasons than non-residence in Germany. This would be relevant e.g. for private as well as for public lessors.

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Finland - Changes to taxation of non-residents' Finnish source earned income

On 26 October 2005, the Finnish Parliament approved changes to the taxation of non-residents´ Finnish source earned income. The changes are made in the aftermath of the European Commission's infringement procedure and the pending Turpeinen case (C-520/04). The changes are intended to facilitate the equal treatment of resident and non-resident recipients as to the Finnish source pension income and employment income.

-- Jarno Laaksonen, Finland; Jarno.Laaksonen@fi.pwc.com

Italy – Lower Court judgments on IRAP

In Italy, two Lower Courts passed judgments in recent months in respect of the IRAP Case (C-475/03) following the A-G's opinion handed down on 17 March 2005. The issue is whether the Italian IRAP is compatible with the EU Sixth VAT Directive (77/388/EEC) given that IRAP is quite similar to the EU-regulated system of value added taxes. The A-G shared the view of the claimant, Banca Populare di Cremona that IRAP is in breach of EU law, as it has the essential features of VAT and is therefore forbidden under Article 33 of the EU Directive.

On 27 May 2005, an Italian Lower Court admitted a claim made by a taxpayer in order to obtain the reimbursement for IRAP paid arguing that IRAP has the same features as VAT and therefore, IRAP is a forbidden tax under Article 33 of the Directive. On 20 September 2005, however, another Italian Lower Court, deciding on a similar claim made by a taxpayer in order to obtain the reimbursement for IRAP paid and also based on the incompatibility of the IRAP with Article 33 of the Directive, rejected the claim. The Court argued that the features of IRAP are different from VAT features and that IRAP is compatible with EU law. The Court added that since Article 33 of the Directive provides for an imprecise, vague and generic prohibition, and that the ECJ cannot overrule such imprecision. Therefore, the Court deemed a preliminary ECJ ruling not necessary given the fact that it is the competency of national Courts to declare the precise interpretation of Article 33 of the Directive.

-- Claudio Valz, Italy; claudio.valz@studiopirola.com

Netherlands – Lower court judgement on withholding tax on outbound dividends (C-03/01980)

X Sarl, incorporated under the laws of Luxembourg and a resident for tax purposes of Luxembourg, owns 2.25% of the shares in A N.V., incorporated under the laws of the Netherlands and a resident for tax purposes of the Netherlands. A N.V. distributed dividends to X Sarl in 2001 and 2003, which were subject to 25% Dutch dividend withholding tax. Pursuant to the Netherlands-Luxembourg tax treaty the rate of 25% was reduced to 15%, and therefore X Sarl was entitled to a refund of 10%. Based on EU law, X Sarl applied for an exemption from Dutch dividend withholding tax with respect to the dividends received from A N.V. The Dutch Dividend Withholding Tax Act provides for two exemptions in shareholder / investee company relations. The first exemption applies to dividends distributed by Dutch companies to other Dutch companies, to which, for Dutch corporate income tax purposes, the participation exemption applies. The second exemption applies to cross-border dividends, which are covered by the EU Parent-Subsidiary Directive. Since the interest in A N.V. held by X Sarl was less than 25%, the dividend did not qualify for an exemption from withholding tax pursuant to the Directive. Since X Sarl was a resident of Luxembourg, the internal exemption from dividend withholding tax applied neither.

On 13 October 2005, a Dutch Lower Court opined that the internal exemption is not in line with Art. 56(1) of the EC Treaty, as it effectively differentiates between resident and non-resident shareholders. It is contrary to EU law that X Sarl is subject to 15% withholding tax in the Netherlands whereas a Dutch resident shareholder receiving the same dividend would not be subject to any withholding tax or corporate income tax in the Netherlands at all. It should be noted that the Dutch participation exemption should have applied to the interest in A N.V. held by X Sarl, if it would have been a resident for tax purposes of the Netherlands. Subsequently, the Court addressed the issue whether, under these circumstances, a resident shareholder and a non-resident shareholder are comparable. Referring to the Asscher case (C-107/94), the Court stated that it is of no relevance that X Sarl is not subject to Dutch corporate income tax. The only relevant

criterion is that X Sarl is, in principle, subject to corporate income tax in a EU Member State. Therefore, the situation of a resident shareholder and a non-resident shareholder is, in principle, comparable. In addition, this position is confirmed by the circumstance that the dividends distributed by A N.V. to X Sarl are also exempt from corporate income tax in Luxembourg. According to the Court, the tax withheld in the Netherlands on dividends distributed to non-resident shareholders constitutes a restriction of the free movement of capital. In this particular case, the restriction cannot be justified by the principle of territoriality or the coherence of the Dutch tax system.
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Netherlands – Supreme Court judgment on procedural costs (C-35.927)

On 18 September 2003, the ECJ ruled in the Bosal Holding BV Case (C-168/01) that the Dutch Corporate Income Tax Act provision, which excludes financing costs from deduction if the costs relate to tax-exempt non-resident participations, whereas these costs are deductible if they relate to resident tax-exempt participations, is in breach of the freedom of establishment. After this decision, the Dutch tax authorities imposed an additional corporate income tax assessment on Bosal Holding BV, which was fully in line with the ECJ ruling. Subsequently, Bosal Holding BV withdrew its appeal before the Dutch Supreme Court, except for its request to order the Dutch Under-Secretary of Finance to pay the full procedural costs made by Bosal Holding BV. The latter argued that it was entitled to a reimbursement of the full procedural costs because the court procedure was based on a right derived from EU law. Dutch administrative law allows the courts to order an administrative body to pay the procedural costs made by the litigant. However, as a general rule, the Dutch Decree on Procedural Costs (Besluit proceskosten bestuursrecht) only provides for lump-sum reimbursement. Contrary to the general rule, individual circumstances may justify a higher remuneration.

On 7 October 2005, the Court established that the mere fact that a position taken by an administrative body appears to be in breach of EU law does not qualify as a circumstance which justifies reimbursement of the full procedural costs. Neither the fact that the actual procedural costs made by Bosal Holding BV substantially exceeded the lump-sum reimbursement justified a deviation from the general rule. Finally, the Court took into consideration that according to settled ECJ case law, national procedural rules may not be such that it is either almost impossible or extremely difficult for litigants to realise claims to rights derived from EU law. From that perspective, it cannot be concluded that a lump-sum reimbursement instead of a reimbursement of the full costs itself should be enforced by EU law.
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Netherlands – A-G opinion on term for refund of withholding tax under the Dutch-Belgian tax treaty (C-41.568)

X, individual and tax resident of Belgium, received dividends from a Dutch resident company in 2000, which dividends were subject to 25% Dutch dividend withholding tax. Under the then applicable Dutch-Belgian Tax Treaty, the Netherlands were entitled to tax dividends at the rate of 15% to the extent that the dividends are distributed to individuals who are tax residents of Belgium. According to the Protocol to the Dutch-Belgian Tax Treaty, a request for a refund of withholding tax on dividends, interest or royalties has to be submitted within two years after the calendar year in which the tax was withheld. In this case, X submitted his request for a refund in 2003. The Dutch tax inspector dismissed X's request because it had not been submitted in due time. X appealed against this decision and a Dutch Lower Court judged in favour of the tax inspector.

In his opinion to the Dutch Supreme Court of 6 September 2005, the A-G holds that the Court is obliged to consider the case *ex officio* in the light of the free movement of capital. In respect of the procedural rules on a refund of Dutch dividend withholding tax, the A-G states that there is no difference between a resident shareholder and a non-resident shareholder. Depending on the actual facts, the term during which a request for refund can be made by Dutch resident individual shareholders amounts to 3 or 5 and sometimes even 10 years after the calendar year in which the dividend tax has been withheld. A less favourable term applying to non-resident individual shareholders, such as the term under the Dutch-Belgian Tax Treaty, discriminates against non-residents and therefore constitutes a restriction of the free movement of capital, which, in the opinion of the A-G cannot be justified by any rules of reason recognised by the ECJ. Considering that up until now the ECJ only ruled on inbound dividends (e.g. Lenz case (C-315/02) and Manninen case (C-319/02)), and a referral to the ECJ has been made on outbound dividends (Denkavit case C-283/94) the A-G advises the Court either to refer the case to the ECJ or to postpone its decision.
In a Decree dated 21 October 2005, the Dutch Under-Minister of Finance responded to this conclusion and extended the term of 2 years to 3 years for Belgian residents claiming back Dutch withholding tax under the old Dutch-Belgian Tax Treaty for the year 2002 (ie refund requests should be submitted before 31 December 2005). In 2003 a new treaty came into force.
-- Irma van Scheijndel, Netherlands; irma.van.scheijndel@nl.pwc.com

Netherlands - Lower Court judgment on cross-border aspects of a fiscal unity (case 00/03547)

X BV (parent) and Y BV (subsidiary) formed a fiscal unity as from 1 January 1993. Y BV acquired the real estate owned by X BV for debt in 1996. Subsequently, the real seat of X BV was transferred to Belgium. As under the former fiscal unity rules incorporation under Dutch law was sufficient for a company to form part of a fiscal unity, the fiscal unity X BV and Y BV continued to exist after the transfer of X BV's real seat to Belgium. The Dutch fiscal unity rules also imply that transactions between fiscal unity companies are not recognised for corporate income tax purposes.

As the interest received by X BV from Y BV was subject to corporate income tax in Belgium, X BV (taxpayer of the fiscal unity) claimed deduction of the interest payments by Y BV to X BV. The tax inspector denied the deduction of interest. X BV appealed against the decision of the tax inspector and argued that denial of the deduction of interest impedes the transfer of the real seat from the Netherlands to another EU Member State and is, therefore, in breach of EU law.

On 13 July 2005, a Dutch Lower Court dismissed the claim made by X BV. The Court held that it is inherent to the fiscal unity system that transactions between fiscal unity companies are not recognised, even in a situation as X BV and Y BV. Although the Court regarded the increase of the tax burden as a consequence of the transfer of the real seat of X BV as to impede cross-border movements, that impediment is due to the circumstance that Belgium levies tax on the interest received by X BV, rather than the circumstance that the Netherlands does not allow deduction of the interest paid by Y BV. Under the Dutch fiscal unity rules, such interest is not deductible, irrespective of either the nationality or the place of real seat of the recipient of the interest. Furthermore, it would discriminate against resident fiscal unity creditors if in respect to non-resident fiscal unity creditors the interest were deductible. Finally, the Court noted that X BV and Y BV could have chosen to submit a request with the tax authorities to break up the fiscal unity.
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Portugal - Thin capitalisation rules made compatible with EU law

Thin capitalisation rules were introduced in Portugal in January 1996. Where the indebtedness of a Portuguese taxpayer towards a non-resident entity with whom special relations ("associated enterprise") exist, is deemed excessive (when the debt exceeds twice the equity, i.e. at a 2:1 ratio), the interest paid in relation to the part of the debt that is considered to be excessive will not be deductible for the purposes of assessing taxable income. The State Budget for the year 2006 stipulates that the Portuguese thin capitalisation rules do not apply in case the non-resident entity is resident in a EU Member State. With this change, which had long been anticipated following the decision of the ECJ in the Lankhorst-Hohorst case (C-324/00), Portuguese thin capitalisation rules are now in accordance with the freedom of establishment of Art. 43 EC.

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Portugal – A-G's opinion on State aid on the Azores: Portugal v EC (C-88/03)

The Portuguese Republic brought an action before the ECJ seeking the annulment of the European Commission's decision of 11 December 2002 (2003/442/EC), which classifies as State aid the reduction of personal income tax rates and corporate income tax rates for entities resident in the Autonomous Region of the Azores. The outcome of a formal investigation following the EC's guidelines on the provision of national regional aid, was that the aid in question was considered to be compatible with the EU rules by means of a derogation laid down in Art. 87(3) a of the EC Treaty that aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment is allowed. However, in the view of the Commission, the derogation should only apply to the non-financial sector and not to the financial sector and intra-group services activities. Therefore the Commission ordered Portugal to recover the aid made available to firms carrying on financial or intra-group service activities.

This case raises the important question as to which principles apply in assessing whether or not variations in national tax rates adopted solely for a designated geographical area of a Member State fall within the scope of the EU's State aid rules. This question has never been answered by the ECJ. For geographically limited national tax rate variations to amount to state aid, a tax measure must satisfy the four criteria set out in Art. 87(1) EC including that the measure must favour "certain undertakings or the production of certain goods" (i.e. it must be selective).

The A-G opines that a geographically limited national tax rate variation is not selective if the lower tax results from a decision taken by a local authority that is truly autonomous from the central government of a Member State (institutionally, procedurally and economically autonomous). The A-G considers that, although the Azores are an autonomous region under the Portuguese Constitution with its own government bodies with the power to exercise their own fiscal competence and the right to adapt national fiscal provisions to regional specificities, the decision of the Azores Regional Assembly to take the contested tax reduction was not made truly autonomously, for Art. 87(1) EC Treaty purposes. As, according to the A-G, the other criteria of Art. 87(1) have also been met, he suggests that the ECJ dismiss in its entirety the action for annulment of the Commission Decision.

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Spain - Malta and Cyprus no longer considered as tax havens by the Basque province of Biscay

The tax authorities of Biscay, Spain, have issued an internal order confirming the removal of Cyprus and Malta from their list of tax haven territories. Biscay operates a closed list of tax havens and its regulations on tax havens provide that countries or territories that enter into a tax exchange of information agreement or Double Tax Treaty with an exchange of information clause with Spain, shall automatically cease to be considered as such tax havens upon entry into force of the agreement. As the exchange of information mechanisms set forth in EU law have a wider scope than those generally provided for in double tax treaties or exchange of information agreements, the Biscay tax authorities have confirmed that Cyprus and Malta are no longer considered as tax havens for Biscay tax purposes. The effects of this order are limited to the province of Biscay and that the Spanish tax authorities have not issued a similar ruling so far. Nevertheless, the Spanish regulations on tax havens are identical to those of Biscay and thus there are grounds for upholding that Malta and Cyprus have *de facto* ceased to be tax havens for Spanish purposes upon their accession to the EU.

Biscay is one of the three Basque provinces, which form part of the Kingdom of Spain. The Spanish Constitution recognizes the right of the three Basque provinces (and Navarre) to legislate on tax matters and collect their own taxes. Notwithstanding this, Basque resident individuals and companies are entitled to the benefits of the EU Directives and tax treaties entered into by Spain.

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Spain - Amendment to Spanish regulation on the EU Savings Directive

The original Spanish implementation of EU Directive 2003/48/EC on the exchange of information on preferential participations and other debt instruments and to certain sources of income obtained by EU resident individuals, provided that such information exchange would refer to income *paid* or *accrued* as from 1 July 2005. On 26 September 2005, the Spanish Minister of Economy issued Royal Decree 1122/2005, by virtue of which the mentioned information exchange will refer only to income *accrued* as from 1 July 2005.

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EU DEVELOPMENTS

Council adopts new EU Directive on cross-border mergers

On 20 September 2005, the EU's Council of Ministers adopted a new EU Directive, which aims to facilitate cross-border mergers between various types of limited liability companies in the EU. The Directive aims to reduce many of the problems companies are currently facing with such operations in terms of the legislative and administrative difficulties and costs involved, and provides more legal certainty. Some key features of the Directive include:

- The Directive will apply to mergers of limited liability companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the EU
- Member States can adopt specific provisions for the protection of minority shareholders of a merging company who have opposed the cross-border merger
- The common draft terms of the cross-border merger must be approved by the general meeting of each of the companies concerned in the various Member States
- The monitoring of the completion and legality of the decision-making process in each merging company must be carried out by the national authority having jurisdiction over each of those companies, whereas monitoring of the completion and legality of the cross-border merger should be carried out by the national authority having jurisdiction over the company resulting from the cross-border merger
- The general principle regarding employee participation rights is that the national law governing the company resulting from the cross-border merger will apply
- It appears that the Directive will only apply to those Member States who have or have introduced a concept of domestic legal mergers.

After formal publication of the Directive in the EU Official Journal, the Member States will have two years to adapt their national legislations in accordance with the Directive's provisions.

Click here for the EC press release for more details

-- Bob van der Made, Belgium; bob.van.der.made@pwc.be

Greece - EC requires Greece to suspend illegal tax-exempt fund and opens investigation

The European Commission has required Greece to suspend further granting of illegal State aid in the form of tax breaks under the Greek Law 3220/2004. This law reduces the tax base of many companies in various sectors by 35% of their profits but was never notified to the Commission and it is therefore illegal. At the same time, the Commission has launched an in-depth investigation as it has doubts on whether such aid would be compatible with EU State aid rules (Art. 87) because of the serious risk that it will distort competition in a way liable to affect trade between the Member States. If the Commission finds the State aid to be contrary to EU law, it may require Greece to recover the unlawful aid paid to undertakings with interest.

-- George Samothrakis, Greece; george.samothrakis@gr.pwc.com

Portugal - EC starts State aid inquiry into capital gains tax exemption for public undertakings
On 6 October 2005, the European Commission notified Portugal that it has initiated a formal State aid investigation procedure via Art. 88 (2) of the EC Treaty regarding art. 25 of the Portuguese Tax Benefits Statute. Based on art. 25 of the Portuguese Tax Benefits Statute, companies with exclusively public capital and companies in a controlling relationship with them may exclude from their taxable profit the capital gains derived from privatisation operations and from restructuring processes carried out in accordance with strategic guidelines in the performance of the State's shareholder function and recognised as such by order of the Portuguese Minister of Finance.

The Commission will now investigate a tax exemption granted to Caixa Geral de Depósitos, a bank largely owned by the Portuguese State, in respect of the capital gains realised upon the sale of its participation in the Brazilian bank Itaú, and the sale of participations in various Portuguese banks by its subsidiary, Mundial Confiança, an insurance company.

By enabling public undertakings undergoing a process of privatisation or regulated reorganisation to benefit from an exemption of corporate income tax on certain capital gains, art. 25 of the Tax Benefits Statute grants them an operating advantage compared to other (private) companies. At first sight, this appears to meet the relevant criteria of Art. 87 (1) EC Treaty, as the measure affects EU trade and distorts competition in the financial sector, as well as in other sectors. The parties concerned are now required to submit their comments to the Commission.
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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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