EU Tax News

PRICEWATERHOUSECOOPERS

EU Direct Tax Group   Part of the International Tax Services Network

Issue 2006 – nr. 002 **January / February 2006**

This is the fifth issue of the EU Tax Newsletter, which has been prepared by members of PwC's EU Direct Tax Group (EUDTG). Should you be interested in receiving this free bi-monthly newsletter automatically in the future, then please register online via: www.pwc.com/eudirecttax.

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ECJ CASES

Belgium - A-G Opinion on renewal of the Belgian Coordination Centres (Belgian Government and Forum 187 ASBL v EC (C-182/03 and C-217/03)

On 17 February 2003, the European Commission decided on a gradual phasing-out of the Belgian Coordination Centres by 31 December 2010. As a consequence, the Coordination Centres that were benefiting from the regime on 31 December 2000 and whose status expired between 17 February 2003 and 31 December 2010 could no longer extend their status.

Immediately after the Commission's decision, the Belgian Government together with Forum 187 ASBL launched a case before the ECJ to have the decision annulled either in total or in part. The ECJ issued a preliminary decision on 26 June 2003 partially deferring the Commission's decision.

On 9 February 2006, in his Opinion, the Advocate-General (A-G) said that the denial of the right to renew a Coordination Centre's status between 17 February 2003 and 31 December 2010 as written in the Commission's decision breaches the legitimate expectation of existing Coordination Centres that a renewal process would be possible until at least 2010. By denying this right to the Coordination Centres whose status expired after 17 February 2003, a discrimination was created vis-à-vis the Centres that renewed their status prior to that date.

It is unclear whether the ECJ will follow the A-G, although it is generally expected that it will. In anticipation of the ECJ's decision, there may be opportunities for taxpayers to potentially benefit from the Coordination Centre's status until 31 December 2010.
-- Caroline Goemaere and Laurens Narraina, Belgium; laurens.narraina@pwc.be

Belgium - Referral to the ECJ regarding the application of a minimum tax base for non-residents: Raffaele Talotta v Belgian State case (C-383/05)

In the absence of proper accounting or other conclusive evidence substantiating a taxpayer's taxable profit, section 342, § 1 of the Belgian Income Tax Code (BITC) provides for taxation on the basis of profits normally derived from similar taxpayers taking into account a variety of criteria (e.g. invested capital, turnover, number of workers, etc). Section 182 of the Royal Decree which implements the BITC provides for a further minimum lump-sum taxable basis for foreign companies active in Belgium depending on the nature of their activities which cannot, in any event, be lower than EUR 9.500. The Belgian Supreme Court asked whether the minimum taxable basis for foreign companies, as laid down in Section 182 of the Royal Decree, is contrary to the freedom of establishment under the EC Treaty. The Court therefore referred this question for a preliminary ruling to the ECJ on 7 October 2005**.** As from 1 January 2005, Section 182 also applies to resident companies (for not or not timely filing their tax return).
-- Caroline Goemaere and Laurens Narraina, Belgium; laurens.narraina@pwc.be

Belgium - Referral to ECJ on the taxation of Belgian residents active in other Member States: Lucien de Graaf and Gudula Daniels v Belgian State case (C-436/05)

On 29 November 2005 a Belgian Lower Court referred various questions for a preliminary ruling to the ECJ regarding the taxation of Belgian residents (i.e. individuals) with professional activities in other EU Member States. The first question relates to the Belgian State's levying of a 3% supplementary crisis contribution which is calculated on the tax due. Since this contribution is commonly used by the Belgian State to finance the Belgian social security system, the question arises whether this contribution is in line with EU rules on the free movement of persons if according to the relevant Council Regulation (Regulation No 1408/71 on the application of social security schemes to employed persons, to self-employed persons and to members of their families moving within the Community), a Belgian resident is not liable to pay social security contributions in Belgium (i.e. is subject to contributions in another Member State). It should be noted that the supplementary crisis contribution for individuals has gradually been phased out since 2000. The second question of the Court to the ECJ relates to the comparison of the taxation of residents living in a frontier region and working in another Member State and residents not living in the frontier region and working in another Member State. The third and fourth questions from the Lower Court to the ECJ concern, respectively, "most favoured nation treatment" and non-deductibility of sickness insurance premiums in the hands of a Belgian resident who performs his professional activities almost completely in another Member State. The other questions put to the ECJ relate to the non-deductibility of sickness insurance premiums concluded with a foreign insurance company.
-- Caroline Goemaere and Laurens Narraina, Belgium; laurens.narraina@pwc.be

Belgium - Referral to ECJ on the geographical condition under the exemption for inheritance tax: Geurts and Vogten v Belgian State case (C-464/05)

On 21 December 2005, the Hasselt Court of First Instance referred a request for a preliminary ruling to the ECJ in the context of article 60bis of the Belgian Code of Succession Duties which provides for the exemption of inheritance tax on assets and shares of family businesses transferred at the occasion of a succession. Article 60bis more specifically provides that such exemption is only available if at least 5 employees have been working in the Flemish Region over the last three years preceding the death of the deceased. The question raised is whether this geographical condition (i.e. Flemish Region) is in line with the EU's freedom of establishment and the free movement of capital.
-- Caroline Goemaere and Laurens Narraina, Belgium; laurens.narraina@pwc.be

Germany - ECJ judgment on cross-border consideration of own property losses: Ritter-Coulais case (C-152/03)

The married couple Ritter-Coulais lived in France on their own property in 1987, but both worked in Germany as teachers at a state school and were therefore subject to unlimited tax liability in Germany. At that time, personal use of own property could be made taxable in Germany as rental income, thus allowing the deduction of expenses. German national legislation prescribes that foreign negative income qualified as passive (e.g. rental income) is not deductible from the tax base. At the same time, German case law says that the exemption method in a double tax treaty applies to positive *and* negative income, and negative passive exempt income is not considered when determining the tax rate, while positive passive exempt income is. The couple applied unsuccessfully for a consideration of the losses suffered from their French property when calculating the applicable tax rate. They took the case to the Supreme Court which referred it to the ECJ.

The ECJ noted that the free movement of workers in Art. 39 EC had to be considered and that this had been violated by the German legislation. Working in Germany but residing in another Member State, the Ritter-Coulais were in contrast to persons working *and residing* in Germany not entitled to take into account losses relating to their home for purposes of determining the relevant tax rate. As such, the treatment of non-resident workers is less favourable than that of resident workers. As to Germany's attempt to justify the national provision with the coherence of the tax system, the ECJ stated that according to Art. 39 EC, a system, which takes positive foreign income into account when determining the tax rate but for that purpose denies the consideration of similar losses from the same State, cannot be considered coherent. See EUDTG Newsalert NA 2006 – 03
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-- Christoph Torwegge and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Germany - ECJ judgment on non-deductibility of shareholder expenses on foreign tax-exempt dividends: Keller Holding case (C-471/04)

Keller Holding, a German resident company, held 100 % of another German company, which received foreign tax-exempt dividends in 1994 and 1995 from its Austrian subsidiary. The dividends were subsequently passed on to Keller Holding and remained tax-exempt in accordance with German tax legislation. The tax authorities rejected the deduction of shareholder expenses at Keller Holding's level due to a German provision stating that expenses are non-deductible in so far as they directly relate to tax-exempt income. Keller Holding took the case to the German Supreme Tax Court, which subsequently referred it to the ECJ. The Court asked whether it is contrary to the EU's freedom of establishment if shareholder expenses, which directly relate to tax-exempt income from a holding in a company residing in another Member State, are only deductible as business expenses as far as no profits are distributed on a tax-free basis.

On 23 February 2006, the ECJ confirmed that the freedom of establishment in Art. 43 EC and Art. 31 EEA preclude such national legislation. As far as the taxation of dividends received is concerned, parent companies subject to unlimited tax liability in Germany are in comparable positions regardless of whether they receive intermediate dividends from a second-tier subsidiary established in Germany or from a second-tier subsidiary in Austria. In both cases, the dividends received by the parent company are in reality exempt from taxation. The ECJ stated that the situation of a German company having a second-tier subsidiary in another Member State is less favourable than that of a German company with a second-tier domestic subsidiary, as only in the latter case shareholder expenses in connection with the participation were deductible upon dividend receipt. Such a difference in treatment constitutes a restriction of the freedom of establishment that cannot be justified. The ECJ also noted that the German claim of coherence does not justify the difference in treatment, since in the case of a parent company receiving dividends from a second-tier subsidiary in Germany, the tax advantage consisting in the deductibility of shareholder expenses does not in

fact correspond to any tax levy on the dividends distributed to that parent company. Furthermore, the ECJ rejected any justification attempts on the grounds of the principle of territoriality, as well as the argument that the German legislation merely implements a taxing power provided for in Article 4(2) of the Parent-Subsidiary Directive 90/435/EEC. See EUDTG Newsalert NA 2006 – 04.
-- Christoph Torwegge and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Germany - Judgment in CLT-UFA case (C-253/03): different tax rates for residents and non-residents

CLT-UFA, a Luxembourg resident corporation, maintained a permanent establishment in Germany in 1994 subject to corporation tax in Germany on the income derived from that permanent establishment. The income was assessed at a tax rate of 42 %, applicable at that time to non-resident corporations. CLT-UFA appealed against this and took the case to the German Supreme Tax Court arguing that the tax rate for non-resident corporations was contrary to the freedom of establishment. The German Supreme Tax Court (Court) stated that although a German subsidiary of a non-resident parent was subject to tax rate of 45 % on retained earnings in 1994, this tax rate was reduced to 33.5 % upon distribution to a non-resident parent before 30 June 1996 and thereafter reduced to 30 %. The Court referred the following questions to the ECJ: Does the freedom of establishment preclude national legislation stating that income derived in 1994 by a non-resident corporation through a permanent establishment in Germany was taxed at 42 %, where distributed profits of a German subsidiary were charged with German corporation tax (including withholding tax) at a rate of 33.5 % before 30 June 1996 and 30% after 30 June 1996? Secondly, if this constitutes an infringement of Art. 43, 48 EC, does the tax rate for non-residents corporations have to be reduced to 30%?

On 23 February 2006, the ECJ held that Art. 43 and 48 EC preclude this national legislation as the freedom of establishment expressly grants market participants the right to choose an appropriate legal form for their undertakings in other Member States, i.e. companies are allowed to open a branch in another Member State in order to pursue their activities under the same conditions as those which apply to subsidiaries. The ECJ rejected the tax authorities' and the German Government's claim that a permanent establishment and a subsidiary are objectively not comparable. The ECJ left it to the Court to answer the second question, since the ECJ has no jurisdiction to give a ruling on the facts in an individual case. However, it did instruct the Court to apply the same overall tax rate to the income from the permanent establishment that had applied to a distributing subsidiary. See EUDTG Newsalert NA 2006 – 06.
-- Christoph Torwegge and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Netherlands - ECJ judgment in Senior Engineering Investments B.V. case (C-494/03): no capital duty for subsidiary upon capital contribution by parent company to sub-subsidiary

Senior Engineering Investments B.V. (SEI BV) is a private limited liability company incorporated under Dutch law and established in the Netherlands. All of the shares in SEI BV are held by a company established in the UK (‘the parent company’). SEI BV 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. This capital contribution was not subject to capital duty in Germany, as that country has chosen not to levy capital duty in its jurisdiction. In the Netherlands, capital duty was due by SEI BV. The Dutch tax authorities regarded the capital contribution to the sub-subsidiary as an indirect capital contribution to SEI BV. The company finally appealed to the Dutch Supreme Court, which referred the following questions to the ECJ: is this compatible with Council Directive 69/335 EEC concerning indirect taxes on the raising of capital to levy capital duty on SEI BV, and is such a levy incompatible with the freedom of establishment, since capital duty would not have been due had the sub-subsidiary been resident in the Netherlands?

On 12 January 2006, the ECJ handed down its judgment and considered that, according to the scheme and structure of the Directive, capital duty was to be levied on the capital company receiving the contribution in question. It is only in exceptional circumstances necessary to seek to identify the 'real recipient' of the resources or services in question. Furthermore, it follows from the Directive that capital duty should be charged only once. The contribution in question was paid to the sub-subsidiary in non-exceptional circumstances but the contribution does fall within the scope of Art. 4(2)(b) of the Directive because: i) the payment of the contribution entailed an 'increase in the assets' of the sub-subsidiary; ii) the contribution was one that 'may increase the value of the company's shares'; and iii) the contribution is a 'provision of services by a member' because the contribution must be attributed to SEI BV. Consequently, the contribution is subject to capital duty payable by the sub-subsidiary. Given that a contribution to a company may be taxed only once within the EU that contribution cannot be subject to taxation a second time, payable on that occasion by SEI BV. See EUDTG Newsalert NA 2006 – 01.
-- Sjoerd Douma and Frank Engelen, Netherlands; frank.engelen@nl.pwc.com

Netherlands - ECJ judgment on deemed residence rule inheritance tax not in conflict with free movement of capital: Van Hilten case (C-513/03)

Mrs. Van Hilten-Van der Heijden, a Dutch national, emigrated from the Netherlands to Belgium in 1988 and three years later, in 1991, emigrated from Belgium to Switzerland, where she lived until her death in 1997. Since she was a Dutch national and lived in the Netherlands less than ten years before her death, Van Hilten-Van der Heijden was deemed to be resident in the Netherlands for Dutch inheritance tax purposes. As a result the heirs were liable to Dutch inheritance tax for their share in the inheritance. The heirs appealed against the assessment arguing that the "deemed residence rule was an infringement of the free movement of capital (Art. 56 EC). A Dutch Lower Court referred the case to the ECJ.

In its judgement of 23 February 2006, the ECJ first established that inheritances constitute movements of capital in the meaning of article 56 EC. Subsequently, it held that the deemed residence rule does not restrict the free movement of capital. Firstly, the rule does not create unequal treatment between nationals who have transferred their residence abroad and nationals who have remained in the Netherlands. Secondly, the Member States are free to define the criteria for allocating their powers of taxation by treaty or in their own legislation. As long as there is no harmonisation in the field of direct taxation, the Member States are free to define such criteria. The use of the nationality criterion in Dutch inheritance tax serves as a criterion to allocate taxation rights in accordance with international practice and does therefore not infringe Art. 56 EC. See EUDTG Newsalert NA 2006 – 05.
-- Cees Peters and Frank Engelen, Netherlands; frank.engelen@nl.pwc.com

Netherlands - A-G Opinion: on Magpar VI B.V. case (C-509/04): no transfer of lock-up period share-for-share merger upon subsequent qualifying tax exempt merger

Hoffmann Beheer B.V. ('Hoffmann') is a private limited liability company incorporated under Dutch law and established in the Netherlands. All shares in the company are held by an individual established in the Netherlands. In 1998, this sole shareholder transferred his shareholding in Hoffmann to Magpar VI B.V. ('Magpar') in exchange for an issue of shares by Magpar. This capital contribution was exempt from Dutch capital tax, since the share-for-share merger exemption was applicable. Only a few days later Hoffmann ceased to exist as a result of a legal merger with Magnus Holding B.V. ('Magnus'). Magpar became one of the shareholders of Magnus. On the same day, Magpar transferred its shareholding in Magnus to a newly established co-operative.

The Dutch tax authorities were of the view that the transfer of the shares in Magnus to the co-operative triggered a claw-back of the share-for-share merger exemption at the level of Magpar, because of the condition that the contributed shares (Hofmann) had been disposed of within a period of five years. The previous merger had not triggered a claw-back, however, as according to the tax authorities the lock-up period of the shareholding of Magpar in Hoffmann was transferred to the shareholding of Magpar in Magnus. Following this line of reasoning, the disposal of the shareholding in Magnus to the co-operative triggered a claw-back of the share-for-share merger exemption.

Upon referral, the Dutch Supreme Court asked whether Council Directive 69/335/EEC (concerning indirect taxes on the raising of capital) must be construed in such a way that the lock-up period of the share-for-share merger exemption is transferred to another company if the relevant shareholding is part of a qualifying tax exempt merger. The Court subsequently asked whether the fact that the shareholding in Hoffmann was part of a legal merger and as such had ceased to exist under Dutch civil law was of any relevance, since the applicability of the exemption requires a transfer of the shares.

On 17 January 2006, the A-G delivered his Opinion. On the first question, he concludes that the Directive is clear as it stipulates that where the relevant shares are transferred within a period of five years, the exemption continues to be applicable, if the shares are transferred in the course of a qualifying transaction. The Directive does not provide for any other restriction to the applicability of the exemption. More specifically, it does not leave room for a transfer of the lock-up period to another shareholding. On the second question, the A-G finds that given the general purpose of the Directive's provisions on the applicability of exemptions, there should be no difference between a legal merger and a merger that actually does result in the transfer of the shares.
-- Cees Peters and Frank Engelen, Netherlands; frank.engelen@nl.pwc.com

Sweden - ECJ judgment on different taxation of repurchase of shares for residents and non-residents: Bouanich case (C-265/04)

Mrs. Bouanich is a French resident who held shares in a Swedish investment company. The company repurchased shares from its shareholders, which in Sweden triggers a capital gains tax of 30 %. Swedish residents are taxed on such gain after deduction of base cost and expenses. The gain of a non-resident, on the other hand, 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 %. This rate was applied to the gross selling price. Bouanich appealed and asked for a reduction to zero and secondly, that the tax on the par value of the shares be repaid (the latter was granted by the tax authorities). A Swedish Lower Court referred the case to the ECJ and asked whether a) the different treatment of residents and non-residents in respect of capital gains is in accordance with the free movement of capital in the EC treaty, b) it is consistent with the same freedom to apply the double tax treaty between Sweden and France where this treaty reduces the tax rate on the capital gain and, moreover, grants a deduction of the par value of the shares and c) the treatment is allowed under the freedom of establishment of the EC treaty.

In its judgment of 19 January 2006, the ECJ firstly asserted that the resale of shares to an issuing company constitutes a capital movement as meant in Art. 56 EC. On the first question, the ECJ replied that residents and non-residents are subject to different rules and that the right to deduct base cost is an advantage granted only to shareholders resident in Sweden. The refusal to allow non-residents to deduct base cost therefore constitutes a restriction on the free movement of capital. Art. 58 EC cannot serve as justification for the restriction: Residents and non-residents are in a comparable situation regarding base cost in case of a share repurchase and the different

treatment therefore constitutes an arbitrary discrimination against non-resident shareholders. Other justification arguments were not brought forward.

As to the second question, the ECJ stated that the double tax treaty forms a part of the legal background to the proceedings and as such has to be taken into account when giving the referring Court an interpretation of EU law. The ECJ noted that it must be ascertained whether residents are treated more favourably than non-residents after application of the treaty to decide if there is a restriction. To do so, it is necessary to know both the base cost as well as the par value, which is a matter for the national court. The ECJ held that the free movement of capital precludes the application of such provision of a double tax treaty as in the main proceedings, except where non-residents are not treated less favourably than resident shareholders. Whether this is the case in the specific situation has to be decided by the referring court. In light of the first two answers it was not necessary to answer the third question. See EUDTG Newsalert NA 2006 – 02.
-- Caroline Naumburg and Gunnar Andersson, Sweden; gunnar.andersson@se.pwc.com

UK - A-G Opinion on different tax treatment of dividends for residents and non-residents: Test claimants Class IV of the ACT Group Litigation v CIR (C-374/045)

The ACT Class IV Group Litigation Order is concerned with claims by French, German and Italian resident parent companies with UK subsidiaries that the failure to provide for treaty credits on dividends in the relevant double taxation treaty is in breach of the non-discrimination provisions of the EC Treaty. The UK High Court referred the various questions to the ECJ.

On 23 February 2006, the A-G opined that the UK's denial of tax credits to non-UK resident companies which received dividends from their UK resident subsidiaries is not contrary to the freedom of establishment and free movement of capital provisions of the Treaty.

The A-G considered that 'quasi-restrictions' on cross-border activity which flow from the interaction of national tax systems (such as the existence of cumulative administrative compliance burdens, for companies active cross-border, the existence of disparities between national tax systems, and the necessity to divide tax jurisdiction) should fall outside the scope of Art. 43. Only 'true' restrictions, being restrictions that go beyond those flowing inevitably from the co-existence of national tax systems, should fall within the scope of Art. 43. In determining whether or not a Member State is in compliance with its EC Treaty obligations, the effect of its double taxation agreements should be taken into account as: (a) Member States are free to apportion between themselves both tax jurisdiction and priority to taxation; and (b) if the effect of a double taxation agreement were not taken into account, this would ignore the economic reality.

The A-G concurred with the ECJ's judgment in the D case (C-376/03) that a Member State is not obliged to extent 'Most Favoured Nation' treatment to residents of other Member States. The A-G considered that the conditions in the double taxation treaty form part of the balance of tax jurisdiction and priority to taxation agreed between Member States and does not fall within the scope of Article 43. The A-G also opined that the UK should apply the Manninen judgment.
-- Peter Cussons and Chloe Paterson, UK; peter.cussons@uk.pwc.com

UK - ECJ VAT clause of rights: Joined Halifax, BUPA Hospitals and University of Huddersfield cases (C-255/02, C-419/02 and C-223/03)

The ECJ has ruled that supplies entered into solely for the purposes of gaining a tax advantage do qualify as supplies made in the course of economic activities; whilst the principle of abuse of Community law does apply to VAT, but only in limited circumstances.

The fundamental issues being addressed by the ECJ in these cases were:

- Whether transactions entered into solely for the purposes of enabling input tax to be deducted qualify as 'supplies' in the course of an 'economic activity' ('the supply issue'); and
- Whether the doctrine of 'abuse of rights' operates to disallow the taxpayers right to deduct input tax ('the abuse issue').

In relation to the supply issue, the ECJ has ruled that the terms 'economic activity', 'supply of goods' and 'supply of services' are objective in nature, and should be interpreted without reference to the purpose or results of the transactions in question. Accordingly, the fact that economic activities are carried out, or supplies made, with the sole intention of gaining a VAT advantage, does not preclude such transactions from falling within the scope of VAT.

In relation to the abuse issue, the ECJ has affirmed the principle that Community law cannot be relied on for abusive means or for the purpose of wrongfully obtaining advantages provided for by Community law, and that this principle does apply to VAT. However, the ECJ has confirmed that this principle can only apply if the following two conditions are met:

- Notwithstanding the fact that the formal conditions for securing the particular advantage have been met, the granting of that advantage would be contrary to the purpose of the particular provisions.
- It is apparent from objective factors that the essential aim of the transactions concerned is to obtain that advantage. In considering these factors, the substance and significance of the transactions concerned needs to be established. This evaluation may take account of factors such as the artificial nature of the transactions and the legal, economic and personal links between the parties.

Where the two above tests are satisfied, the transactions must be redefined or reconstituted, to establish the transaction which would have been carried out in the absence of the abusive transactions.

It is difficult to be certain whether and if so how far this judgment extends beyond VAT, and in particular whether it would apply to taxpayers relying on fundamental freedoms in the EC Treaty in relation to direct taxes. Generally the ECJ seems to be taking care to limit the scope of its judgment to VAT issues, but in other places it might appear to be making more general observations. As so often after a case of this nature, more cases such as Cadbury may well be needed before the scope of the abuse of rights doctrine becomes clearer.
-- Peter Cussons and Chloe Paterson, United Kingdom; peter.cussons@uk.pwc.com

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NATIONAL DEVELOPMENTS

Denmark - New rules adopted in Danish law to comply with the EU Merger Directive

Denmark has implemented Council Directive 2005/19/EC. which amends the Merger Taxation Directive (1990/435/EC) into Danish legislation by the enactment of Bill L 19 on 6 December 2005. The act came into force on 1 January 2006.

The aim of the Directive is to defer taxation of income, profits and capital gains in connection with business reorganisations and to protect the taxation rights of member countries.

Previously the Merger Taxation Directive only applied to limited liability companies and private limited companies, but it now applies to other companies which are liable to tax according to the Danish Corporation Tax Act on the condition that their taxable income is calculated and taxed in accordance with the general tax rules applicable to limited liability companies. The number of companies which can carry out tax-exempt reorganisations as described in the Merger Taxation Directive has thereby been considerably increased.

The new companies comprised by the Directive are all liable to tax in the Member State in which they are resident, but some of the companies may be categorised as transparent entities by other Member States. The new Directive contains a provision enabling Member States to have the option not to apply the relevant provisions in the Directive when taxing a direct or indirect shareholder of those taxpayers. In Denmark, the rules on tax-exempt exchanges of shares and tax-exempt mergers will not apply when one of the companies is categorised as transparent when taxed in Denmark. A provision has also been introduced that a foreign company which is categorised as transparent when taxed in Denmark in connection with a reorganisation is entitled to relief for the tax paid abroad.

The definition of exchange of shares has been extended to also apply in situations where a company already has a majority of votes in the other company and subsequently acquires additional shares. According to the previous Danish rules the provision only applied to exchanges of shares where the company acquired a majority of votes in another company. With the implementation of the new Directive the rules on tax-exempt exchanges of shares apply for all exchanges of shares where a company acquires or already has a majority of the votes.

The tax treatment of the transfer of the registered office for a SE company or a SCE company is regulated in the amendments to the Merger Taxation Directive. In Denmark the provision has been implemented by applying the general rules for exit taxation to SE and SCE companies. When they cease to be taxable to Denmark, these companies will be taxed on the fair value of assets and liabilities at the date of exit.
-- Annette Boysen and Søren Jesper Hansen, Denmark; soren.jesper.hansen@dk.pwc.com

Finland - Advance ruling on Finnish-source dividends received by Luxembourg SICAV

The Finnish Central Tax Board (CTB) issued an advance ruling on 25 January 2006 in a case concerning the Finnish right under EU law to impose withholding taxes on Finnish-source dividends received by a Luxembourg SICAV from its 100 % owned subsidiary in Finland.

The CTB stated in its decision that as the SICAV is not mentioned in the appendix of the Parent-Subsidiary Directive and it does not pay corporate tax in Luxembourg, the SICAV is not considered as a qualifying company under the Parent-Subsidiary Directive. For this reason, it is not exempt from withholding tax under the Finnish domestic rules implementing the Directive.

The taxpayer reasoned that the fundamental freedoms of the EC Treaty precluded Finland from imposing taxes on the dividend receipts as such dividends received by Finnish resident limited liability companies or investment funds would have been tax-free. In reply to this argument the CTB stated that for Finnish purposes the Luxembourg SICAV indeed resembles most Finnish limited liability companies (*osakeyhtiö*). However, due to the differences between these two legal forms, the CTB found the situations of resident and non-resident taxpayers not to be objectively comparable. Following this, the CTB ruled that the EC Treaty does not prohibit Finland to levy withholding taxes on the dividends received by the SICAV.

The ruling is not yet legally binding and the taxpayer may appeal the case before the Finnish Supreme Administrative Court, which in turn could refer the case to the ECJ.
-- Lari Hintsanen and Jarno Laaksonen, Finland; jarno.laaksonen@fi.pwc.com

Ireland – Irish Finance Bill 2006 published

The Irish Finance Bill 2006 was published in early February 2006 and contains provisions which transpose the 2005 amendments to the 1990 Mergers Directive into Irish law. The changes introduced aim to ensure that cross-border mergers, transfers and exchange of share transactions involving European companies (SE or SCE entities) are brought within the scope of the existing Irish legislation. The key sections of the Finance Bill include:

- (i) provisions for determining residence where a SE or SCE has its registered office in Ireland;
- (ii) provisions for establishing a "group" where a principal company becomes an SE/ SCE or mergers into an SE / SCE;
- (iii) provisions governing the impact of a company ceasing to be resident in Ireland as a result of forming or merging into a SE or SCE; and
- (iv) provisions governing the transfer of Irish assets on creation of a SE or SCE. The amendments also make provision for the extension in the Mergers Directive for hybrid entities.

There are also some minor amendments introduced in relation to retention of records which relate to the domestic provisions implementing the EU Savings Directive. In addition the bill confirms the abolition of Irish capital duty.
-- Mary Walsh, Ireland; mary.walsh@ie.pwc.com

Netherlands - Differential tax treatment of non-resident and resident associations and foundations abolished

In the Netherlands, resident associations and foundations are subject to corporate tax if and to the extent these entities carry on an enterprise. Non-resident associations and foundations which own immovable property situated in the Netherlands are deemed to conduct a business in the Netherlands. Consequently, income from Dutch immovable property is always subject to corporate tax for such non-resident entities, while for such resident entities the taxation of that income is not subject to corporate tax, if they do not conduct a business, or if they do, the immovable property does not form part of the business assets.

In a Decree issued on 5 January 2006, the Dutch State Secretary for Finance abolished the different tax treatment between resident and non-resident associations and foundations. Under certain conditions Dutch immovable property owned by non-resident (religious) associations and foundations will no longer be subject to corporate tax in the Netherlands, namely:

- (i) the legal form of the foreign entity corresponds with that of the comparable Dutch entity;
- (ii) the immovable property does not form part of the foreign entity's business assets, if any;
- (iii) the foreign entity files the memorandum of association and the report of accounts with the Dutch tax inspector.

The Decree obviously anticipates the forthcoming ECJ decision in the Stauffer case and it is in line with the A-G's Opinion of 15 December 2005 in that case (see EUDTG Newsalert NA 2005 – 18).
-- Irma van Scheijndel, Netherlands, irma.van.scheijndel@nl.pwc.com

Netherlands - A-G Opinion in Dutch case on extension of 'Bosal' to third countries (41 815)

The taxpayer concerned is a private limited liability company that is established in the Netherlands. The company is a holding company owning majority shareholdings in companies that are established inside the EU as well as companies that are established outside the EU. One of the latter companies was established in Poland (not part of the EU in the relevant year). The taxpayer incurred general expenses in connection with its participations. Following the decision of the ECJ in the Bosal case (C-168/01), the expenses in connection with the participations established inside the EU were tax deductible for Dutch corporate income tax purposes. The tax inspector denied the expenses in connection with the participations that are established outside the EU.

The taxpayer is of the view that the non-deductibility of the expenses infringes article 56 of the EC Treaty, pursuant to which all restrictions on the free movement of capital between Member States and third countries is prohibited. The Dutch tax authorities disagree with this view and argue - amongst others- that the standstill provision of Art. 57 (1) EC Treaty is applicable**.** This provision reads as follows: "The provisions of Art. 56 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Community law adopted in respect of the free movement of capital to or from third countries involving direct investment -including in real estate- establishment, the provisions of financial services or the admission of securities to capital markets."

The Regional Court of Appeal of Amsterdam decided that the non-deductibility does not constitute an infringement of the free movement of capital, without having the case referred to the ECJ. The taxpayer appealed before the Dutch Supreme Court.

The A-G, whose opinion is not binding for the Supreme Court, is of the view that the Court does not have to refer the case to the ECJ, as there is no reasonable doubt that the standstill provision of Art. 57 (1) EC is applicable. First of all, the restriction existed on 31 December 1993. The fact that the relevant provision of Dutch law was slightly amended after this date does not affect this view, since the purpose of the provision has not changed. Secondly, it is beyond reasonable doubt that owning a majority shareholding qualifies as one of the categories of capital movement mentioned in this paragraph. It qualifies both as 'direct investment' and 'establishment'. The A-G does not agree with reasoning of the taxpayer that the standstill provision is only applicable if the relevant provision of national law is *specifically applicable* to (i.) capital movements with third countries and (ii.) one of the mentioned categories of capital movement in that paragraph. The A-G argues that this view of the taxpayer would render this provision meaningless.

Since there is no reasonable doubt that the standstill provision is applicable in this case and there even is a rule of reason justification for the restriction (matching of profits and losses (expenses) in the same jurisdiction), other issues that are not clear need not be referred to the ECJ. Furthermore, the A-G gives an interesting analysis of some issues on the interpretation of the third country scope of the free movement of capital.

First of all, it is the A-G's view that the free movement of capital is applicable in a situation that would be within the scope of the freedom of establishment if it were an investment made in a company that is established inside the EU. Secondly, he takes the view that there are some good grounds to argue that the free movement of capital with third countries has a less far-reaching scope than the free movement of capital between Member States. Lastly, the A-G argues that the

provision on the freedom of establishment in the Association Agreement between the European Communities and Poland does not help the taxpayer with respect to the deduction of the general expenses incurred in relation to its shareholding in the company that is established in Poland. This provision does not have the same scope as the freedom of establishment in the EC Treaty.
-- Cees Peters and Frank Engelen, Netherlands; frank.engelen@nl.pwc.com

Netherlands - Dutch Lower Court judgment on non-deductible expenses for second-tier non-EU participations and less than 25% EU participations (case 04/04448)

There are several cases pending before Dutch courts in order to explore the scope of the ECJ decision in the Bosal case (C-168/01), in which the ECJ held that the non-deductibility of expenses for tax exempt participations was in breach of the freedom of establishment (Art. 43 EC) because the provision only applied to participations of which the profits are not taxable in the Netherlands.

In the case at hand, case 04/04448, a Dutch BV (NL) directly owned a 99.9% participation in Luxembourg (LUX), a 6.37% and 100% participation in Spain ((SP 1) and (SP 2)) and a 100% participation in Switzerland (SWI). SP 2 owned 69.33% in SP 1. The aforementioned participations qualified for the participation exemption. NL incurred expenses in relation to its subsidiaries, part of which related to non-EU participations held by LUX and SP 1 and SP 2. Based on the ECJ decision in the Bosal case, NL deducted the full expenses from its taxable profit. The tax inspector denied the deduction of the expenses as far as they were allocated to SWI, the second-tier non-EU participations and SP 1.

In its judgment of 1 February 2006, a Dutch Lower Court first held that the costs made for SWI were not deductible, referring to its previous judgment ruling that - although the non-deductibility of financing costs related to non-EU participations restricted the free movement of capital between EU Member States and third countries (Art. 56 EC) - the restriction was grandfathered by the standstill clause as meant in Art. 57 EC.

The Court then went on to admit the deductibility of the expenses allocated to the second-tier non-EU participations (directly held by LUX, and SP 2). In the Court's opinion, the Parent Subsidiary Directive has to be interpreted in such a way that the profits resulting from non-EU participations by an EU subsidiary should be regarded as profits from the subsidiary's business in its EU Member State. For that reason, the expenses made for the second-tier non-EU participations have to be allocated to the business of LUX and SP 2. Consequently, these expenses are governed by the Parent Subsidiary Directive meaning that they are deductible following the ECJ's Bosal judgment.

Lastly, the Court also admitted the deductibility of the expenses made for the 6.37% participation in SP 1. According to the Court, the non-deductibility of the expenses restricted the freedom of capital movement (Art. 56 EC). The standstill clause (Art. 57 EC) does not apply to capital movements between Member States and from the ECJ decision in the Bosal case it can be derived that the restriction cannot be justified. The Court held that there is no reason to make a difference between the freedom of establishment and the free movement between EU Member States when grounds of justification are concerned.
-- Irma van Scheijndel, Netherlands, irma.van.scheijndel@nl.pwc.com

Netherlands - Supreme Court judgment on EU Merger Directive (case 41 990)

According to the Dutch Corporate Income Tax Act, tax deferral upon a legal merger can be obtained if, amongst others, the later levying of tax is ensured. However, to the extent that that condition is not met, a tax deferral may be obtained upon request, albeit with the imposition of additional conditions. One of these conditions is that if, at the time of the merger, either the disappearing company or the acquiring company holds a participation which business has (almost) ceased to exist (or the decision thereto has been made), future liquidation losses can only be set off against the profits derived from the assets which can be allocated to either the disappearing company or the acquiring company.

In 2001 A NV merged into X NV. Preceding the merger the business of two foreign participations held by A NV had (almost) ceased to exist. In 2002 the aforementioned participations were liquidated. A NV filed a request with the tax inspector in order to have certainty in advance that the merger facility was based on predominantly sound business reasons. The tax inspector decided in the affirmative, however, he imposed additional conditions. A NV appealed against the condition which restricts the set off of deferred liquidation losses, arguing that that condition was in breach of the EU's Merger Directive (2005/19/EC). A NV stated that since the tax inspector had affirmed the business motives for the merger, and consequently, the anti-abuse provision of the Merger Directive (Art. 11) was not applicable, the Merger Directive did not leave room for other anti-abuse provisions.

On 28 March 2005, a Dutch Lower Court held that the relevant condition aims at ensuring the later levying of tax, which is in accordance with the Merger Directive. From the Preamble of the Merger Directive it can be derived that the Directive seeks a balance between deferring taxation and ensuring the ultimate taxation of the Member States. Furthermore, Art. 6 of the Directive, which deals with carry over losses, is not mandatory but optional.

The Supreme Court dismissed the appeal by A NV on 3 February 2006 briefly stating that there is no reasonable doubt that the condition which restricts the set off of deferred liquidation losses, is not in breach of the Merger Directive. That condition does not deprive the parties involved in a merger from making use of the tax facility.
-- Irma van Scheijndel, Netherlands, irma.van.scheijndel@nl.pwc.com

Netherlands – A-G Opinion on transfer tax upon inheritance by a non-resident: deductibility of costs (39.819)

According to the Dutch Inheritance Tax Act a transfer tax is payable when certain domestic assets, e.g. real estate, pass by inheritance from persons whose last place of residence was outside the Netherlands. In a case in which the A-G Wattel delivered an Opinion (22 December 2005, published 24 February 2006), the testator was a resident of Italy. He had assigned all of his assets and liabilities to his wife under the obligation to pay out to their four children their portions at a certain moment in the future. The inheritance included a private dwelling situated in the Netherlands. The widow of the testator was assessed for the value of this dwelling. She could not deduct the debts owed to her children with respect to the aforementioned obligation. A deduction would have been possible if the testator had lived in the Netherlands. The question arises to what extent this difference constitutes a restriction of the free movement of capital enshrined in Art. 56 EC.

The A-G is of the opinion that the Schumacker doctrine is applicable to the Dutch transfer tax. Since the deduction in question does not relate to the taxpayer's personal and family circumstances, the Netherlands is under the obligation to allow the deduction (see the cases of Barbier, Gerritse and Bouanich). It is of no importance that the Netherlands does not tax the

children for the claims which correspond to the debts of their mother, because nothing prevents the Netherlands from taxing the children. The grant of a deduction by the Netherlands, however, would not put the mother in a better position. After all, Italy allows a credit for the tax payable in the Netherlands, as a result of which a deduction in the Netherlands results in a correspondingly higher taxation in Italy. So, the Dutch and Italian inheritance tax rules are dovetailed. The A-G advises the Dutch Supreme Court to refer the case to the ECJ to clarify the relevance of this particular aspect (see also pending Denkavit and Amurta cases).
-- Sjoerd Douma, The Netherlands; sjoerd.douma@nl.pwc.com

Netherlands – Dutch Lower Court judges limitation on interest deduction in cross-border situation not in breach with Community law (05/914)

Mr A is a resident of Switzerland and the only shareholder of X BV (the taxpayer in the proceedings), a company which is a resident of the Netherlands. X BV holds all shares in another Dutch BV, which were sold to X BV by Mr A in 1998. The purchase price was converted into a loan and, subsequently, into an annuity insurance. According to Art. 10a of the Dutch Corporate Income Tax Act, interest payments to a related entity or a related individual are – among others – not deductible to the extent that the loan concerns an acquisition of shares in a related entity. X BV contended i) that the payment of an annuity cannot be regarded as a payment of interest and ii) that Art. 10a infringes Art. 56 EC, because the payments made to Mr A would have been deductible had Mr A been a resident of the Netherlands (in that case, the amount received by Mr A would have been subject to a taxation which is reasonable according to Dutch standards). The District Court of Breda rejected both arguments. With respect to the Community law argument, the Court considered that X BV cannot invoke Art. 56 EC because there was no business reason for the transfer of the shares in the Dutch company to X BV. The essential aim of the transactions concerned was to obtain a tax advantage. Therefore, X BV cannot rely on Community law, the Court said.
-- Sjoerd Douma, The Netherlands; sjoerd.douma@nl.pwc.com

Norway - Norwegian Government withdraws appeal to Supreme Court in Fokus Bank case

The Norwegian Government has withdrawn its appeal to the Norwegian Supreme Court in the Fokus Bank case. Fokus Bank won its case before the Norwegian Appeal Court in May 2005 after the EFTA Court had given its opinion in case E-1/04 of 23 November 2004 that the Norwegian withholding tax regime on dividends conflicted with Art. 40 of the EEA Agreement (which mirrors Art. 56 of the EC Treaty). The disputed years relevant in this case were 1997 and 1998. The Norwegian imputation system at that time gave Norwegian shareholders full tax credit while foreign-resident shareholders had no such right. Section 3-3 of the Corporate Tax Act (for the relevant years) reads: “Imputation tax credit means the dividend received multiplied by the shareholders’ tax rate for general income.”

In a press release on 27 January 2006, the Norwegian Ministry of Finance stated that after a new and thorough evaluation of the case, the government accepts that the EEA law has been implemented as national law in such a way that it can be a legal basis in specific tax assessment cases. The Finance Ministry also said that it would soon issue guidelines regarding similar cases, and that the starting point for these will be the relevant provision in the Norwegian Tax Assessment Act that sets a three year limit for bringing cases where the tax authorities come to a new understanding of the tax law.

In a new press release on 6 March 2006, the Finance Ministry confirms that in its opinion there is a three year limit for reassessments. The Ministry gives the example that if the taxpayer put forward the refund claim in 2006, he will be entitled to a refund back to and including dividends distributed in 2003. In principle, the tax authorities may deny such a claim, but the Ministry recommends that

all such claims are accepted if the documentation is sufficient. The basic documentation requirements will be:

- The shareholder's/taxpayer's identity;
- The taxpayer's resident for tax purposes;
- The ownership and that the taxpayer is entitled to dividends; and
- The withholding tax and the dividends received.

When accepting such a claim, the Norwegian tax authorities will probably send information to the State were the shareholder is resident. The aim will be to avoid any tax credit in the other country, since the Norwegian withholding tax has been refunded.

We estimate that the refund process will take between eight to twelve months.
-- Bjørn Slåtta and Anders Heieren, Norway; anders.heieren@no.pwc.com

Portugal - Exit tax upon the transfer of the seat or place of effective management

The Portuguese Budget Law for 2006 has established that the transfer from Portugal of the seat or place of effective management of a Portuguese company gives rise to a taxable capital gain or loss equal to the difference between the market value of the assets and their net book value. The same treatment will be applicable if a permanent establishment (PE) ceases its activities in Portugal or transfers its assets situated in Portugal to somewhere abroad.

However, if the assets and liabilities of the company remain in Portugal as part of the property of a Portuguese PE, contributing to its profit, those capital gains will not be subject to taxation. In such circumstances, losses relating to the taxable periods prior to the transfer of the seat or place of effective management of the company may be deductible at the level of the surviving PE.

In addition, the shareholders of a Portuguese company that transfers its seat or place of effective management abroad are subject to tax on the difference between the company's net assets (value at the time of the transfer at market prices) and the acquisition cost of participation. This rule as such will not be applicable to the transfer of seat of a European Company (SE) or a European Cooperative Society (SEC). These new rules are the result of the implementation of the latest amendment to the EU's Merger Directive (2005/19/EC). Editors' note: The compatibility of such exit tax provisions with the freedom of establishment as regards intra-EEA transfers of seat is questionable.
-- Leendert Verschoor and Jorge Figueiredo, Portugal; jorge.figueiredo@pt.pwc.com

UK - Finance Bill 2006: Group relief changes following the Marks & Spencer judgment

On 20 February 2006, the UK's HMRC issued a press release in February regarding group relief changes following the Marks and Spencer judgment. In paragraph 2 of the press release, HMRC states: "In its judgment, the Court confirmed that the UK's group loss relief rules are in principle compatible with European law." If one accepts the 'wider' interpretation of the ECJ judgment, then this statement is incorrect.

Nonetheless, the changes proposed by HMRC would probably bring UK legislation into line with EU law, provided that the proposed anti-avoidance measures meet the ECJ's test in paragraph 57 of their judgment: "...Member States are free to adopt or to maintain in force rules having the specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose is to circumvent or escape national tax law...". In other words, the anti-avoidance provisions should only catch 'wholly artificial arrangements' and not commercially driven transactions.

The press release indicates that the effective date of the anti-avoidance measures was the day of issuance of the press release. It is unclear whether the anti-avoidance measures are intended to have retrospective effect such that, for example, arrangements entered into on or after 20 February could deny loss relief for losses incurred in accounting periods ending before that date. However, if this is the intention, it is arguable that the absence of a transitional period is also in breach of EU law, following Marks & Spencer plc v Commissioners of Customs & Excise (the teacakes case) and having regard to the principles enunciated in the 'Stichting Goed Wonen' VAT avoidance case (where anti avoidance legislation was announced by press release).

It is also unclear what the effective date will be for the other changes (i.e. extension of group relief to include unrelieved losses of companies resident in other Member States). We would expect that the new rules should have no impact on accounting periods already ended (e.g. y/e 31 December 2005). On this basis, and adopting the wider interpretation of the ECJ judgment for the existing group relief rules, it should still be possible to claim relief in those periods from companies resident in other Member States even if the losses have been, or are expected to be, relieved overseas.

For accounting periods which have not yet ended, the position is unclear, but we would argue that the changes should not have retrospective effect, such that the part of the period that pre-dates the change in rules should not be impacted by the change in the rules. The draft legislation giving effect to the changes will form part of the FB 2006 which will be published in April 2006.
-- Peter Cussons and Chloe Paterson, UK; peter.cussons@uk.pwc.com

UK- House of Lords judgment in Pirelli case (ACT Class 2)

Claimants in the ACT group litigation are UK subsidiaries which are claiming compensation for ACT paid on dividends paid to non-UK resident parent companies. This is on the basis that the inability to make a group income election which would have removed the requirement to pay ACT - and which would have been available had the parent company been UK resident - was contrary to the EC Treaty, following the ECJ judgment in the Hoechst case.

Claimants in Class 2 of the ACT litigation, of which Pirelli is the test case, are UK subsidiary companies with parent companies in the Netherlands, Italy or another EU country whose treaty with the UK gave a half tax credit. Under the terms of the relevant double tax treaties, the parent companies were entitled to payment of a tax credit on receipt of a dividend from their UK subsidiaries.

HMRC contended that the payment of the tax credit under the double tax treaty was linked to the payment of ACT by the subsidiary - such that compensation payable to the subsidiary should be reduced to the extent that the parent company received a treaty credit. Both the High Court and the Court of Appeal held, in favour of the taxpayer, that there was no link between the treaty credit received by the parent and the ACT paid by the subsidiary. However, the House of Lords has now allowed HMRC's appeal against those decisions. Surplus ACT claimants should nonetheless receive 72.5 % of their claims.
-- Peter Cussons and Chloe Paterson, UK; peter.cussons@uk.pwc.com

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EU DEVELOPMENTS

European Commission closes infringement procedure against Italian cooperative banks

In June 2002, the National Association of Cooperative Bank Shareholders (ASNAPOP) requested the European Parliament to investigate the incompatibility with EU law of the "special" Italian law on cooperative banks, especially for those listed on regulated markets. This law establishes that different regulations apply to cooperative banks, in virtue of their cooperative legal form, than to other financial institutions. According to the ASNAPOP, the regulations of the "voto capitario" (single vote regardless of the number of shares held), the acceptance clause (authorisation of the directors for the admission of new shareholders) and the limit to the number of shares that can be held (established as 0,5% of the share capital) were contrary to Art. 43 on the freedom of establishment and Art. 56 on the free movement of capital of the EC Treaty.

In October 2003, the European Commission sent a letter of formal notice to the Italian Government requesting it to provide information relevant to its law regarding cooperative banks. The Commission wanted to clarify if, firstly, the Italian cooperative banks - independent of the market listing - were effectively (i.e. not only legally) cooperative companies, assuming that that could justify the existence of special regulations that effectively limit fundamental freedoms, and, secondly, if the regulations in question were proportional to the attainment of the cooperative company objectives.

Having ascertained the cooperative nature of the cooperative banks and after satisfactory clarifications from the Italian side, the Commission concluded in October 2004, that the special regulations can be considered as justifiable restrictions on the fundamental freedoms. The Commission has therefore decided to close the infringement procedure.
-- Claudio Valz, Italy; claudio.valz@studiopirola.com

European Commission takes Italy to the ECJ for failing to recover illegal State aid

Italian Law Decree Nr. 282/2002 and its relevant enactment provisions provide for the application of a tax benefit to all companies with their operational offices located in areas affected by natural disasters. The tax relief provides for the de-taxation of 50% of the increase of the investments in capital goods in excess with respect to the average of the investments realised in the previous five financial years, independently of the damages effectively suffered by the companies in relation to the natural disasters. On 20 October 2004, the European Commission decided that this tax relief was incompatible with EC Treaty provisions on State aid, as there was no connection between the entity of the relief granted and the amount of the damage effectively suffered by the company. Consequently, the Commission ordered the Italian Government to suppress the tax relief and adopt the necessary measures for the recovery from the beneficiaries, of the aid which was illegitimately granted to them. The individual relief was exempted, as this is compatible with EU law (amount of the relief granted cannot be higher than the entity of the damage effectively suffered).

On 26 January 2006, after a year had passed since the Commission sent its formal request to Italy it had still not amended the situation concerning the suspension of the relief regime and the recovery of the aid, the Commission announced that it has decided to bring Italy before the ECJ.
-- Claudio Valz, Italy; claudio.valz@studiopirola.com

European Commission opens formal State aid investigation into Luxembourg 1929 tax-exempt company holdings

In February 2006, the European Commission opened an official investigation into Luxembourg's tax-exempt holding companies, commonly referred to as: "Holding 1929 Companies", in the context of the EU Code of Conduct on harmful tax practices, which was adopted by the EU Council in December 1997. The Luxembourg Holding 1929 regime was identified as harmful State aid by the so-called "Primarolo Report", which pointed out 65 other harmful measures as well.

In June 2003, the Council agreed that the Holding 1929 regime could remain in place but only until 31 December 2010. Two years later, in June 2005, Luxembourg modified the regime slightly and only for Holding 1929 companies established from July 2005 on by prohibiting activities to receive dividends from tax-free companies or from companies benefiting from a low tax rate (below 11%). However, despite these developments, the Commission was still of the opinion that the regime was in fact a State aid incompatible with the EC Treaty and it therefore continued to investigate the issue. In the autumn of 2005, the Commission proposed that the Luxembourg Government should make some amendments to the Holding 1929 regime, which it refused. As a result, the Commission has opened an official investigation, which raises the question whether the Holding 1929 regime really qualifies as a prohibited State aid. It should be noted that two of the four elements which must be present in order to constitute a prohibited State aid are questionable, namely the "specificity" of the regime and whether it affects trade between Member States.
Another question is whether a negative decision by the Commission as to whether the Holding 1929 regime constitutes prohibited State aid, could have retroactive effect. The answer to this is no. Only from the moment the Commission officially and finally publishes the decision that the regime is incompatible with the EC Treaty will the regime have to be cancelled. On the basis of the Opinion of the A-G in the Belgian Coordination Centres case, it could even be argued that the Commission would have to grant some delay after its final decision, in order to allow the existing Holding 1929 companies to take all the necessary measures.

Concerning any other official EU investigations into Luxembourg company tax regimes, the Commission recently requested an explanation from Luxembourg regarding the tax and legal regimes of "SICAR" and "Securitization vehicles", following a complaint addressed to the Commission by an EU Member State.
-- Christian Hannot, Luxemburg; hannot.christian@lu.pwc.com

European Commission requests Portugal to amend discriminatory taxation of foreign banks

In mid-January, the European Commission sent a request in the form of a 'reasoned opinion' (Art. 226 of the EC Treaty) to Portugal inviting it to amend its discriminatory tax legislation applicable to outbound interest payments. According to Art.80(2) (c) of the Portuguese Corporate Income Tax Code, a withholding tax of 20% is applicable to the gross interest paid by Portuguese resident borrowers to non-resident lenders. At the same time, interest paid to resident financial institutions is not subject to withholding tax, although it is subject to the Portuguese corporate income tax; consequently, Portuguese institutions will pay tax only on the net interest they receive. Therefore, in many instances foreign banks pay a higher tax in Portugal than Portuguese banks on the interest they receive on loans made to Portuguese borrowers.

The Commission considers that the higher taxation restricts foreign banks from cross-border lending and that it discourages Portuguese borrowers from taking out mortgage loans or other loans from foreign providers. These taxation rules constitute an infringement of Art. 49 EC Treaty on the freedom to provide services. The Commission claims that the Portuguese system also restricts the free movement of capital (Art. 56 EC). If Portugal does not respond in a satisfactory way to this request within two months, the Commission may refer it to the ECJ.

A similar infringement in case of interest paid to non-resident banks exists in the following situation. According to Art. 29 of the Tax Benefits Statute ("EBF"), interest paid by a resident financial institution to a non-resident financial institution is exempt from withholding tax. However, interest paid by a Portuguese branch of a non-resident financial institution to a non-resident financial institution is not exempt from withholding tax. This is an infringement of Art. 43 EC.
-- Leendert Verschoor and Jorge Figueiredo, Portugal; jorge.figueiredo@pt.pwc.com

European Commission takes Spain to the ECJ over discriminatory capital gains and employment income taxation

On 14 July 2005, the European Commission issued an infringement notice against Spain over its discriminatory taxation of capital gains, employment income, Capital Duty and R&D tax credits. Spain was given two months notice to amend this situation to avoid being referred to the ECJ. However, as no legislative action has been notified to the Commission since then, on 16 January 2006, the Commission announced its decision to refer the case to the ECJ as far as capital gains and employment income taxation is concerned.

Spanish capital gains taxation for Spanish resident individuals is progressive if the assets are sold within the year of acquisition, and a flat 15% rate if sold after one year of tenure. Non-residents are subject to a flat 35% tax rate, irrespective of the period of ownership. Employment income is taxed at progressive rates for Spanish resident individuals, whereas non-residents are taxed at a flat 25% rate. The Commission has deemed both provisions incompatible with the non-discrimination and free movement of capital principles set forth in the EC Treaty. Additionally, it argues that the ECJ "has clearly established in its rulings that it is contrary to EU Law to tax residents and non-residents differently, if there is no objective difference between the situations of the two to justify the difference in treatment".

In view of the above, taxpayers who may have been affected by these provisions should consider filing protective claims to secure their rights under EU law. Otherwise the Spanish statute of limitations might preclude such claims 4 years after the taxable event.
-- Ramón Mullerat, Carlos Concha, David Benito, Spain;
carlos.concha.carballido@es.landwellglobal.com

EU-Switzerland - Update on Art. 15 of the Swiss-EU Savings Agreement

In the summer of 2005, the Swiss Federal Tax Administration (FTA) published official guidelines and forms regarding the application of article 15 (1) of the Swiss-EU Savings Tax Agreement (abolition of withholding tax on cross-border dividends between Swiss and EU resident corporations). Among the most important clarifications was the fact that the minimum holding period can be met post dividend distribution. The payment of withholding tax at the residual treaty rate (or at the full 35% domestic rate for non-treaty recipients such as Cyprus and Malta) will serve as a guarantee for distributions prior to the completion of the minimum holding period. This withholding tax can then be refunded after the completion of the minimum holding period. Currently, no alternative solutions (e.g. notification procedure instead of actual payment and refund) are yet available, even if the residual - and refundable - tax would involve significant amounts. The FTA also clarified that Swiss companies with cantonal privileges (holding, mixed, domiciliary status) may qualify for the benefits of the Savings Tax Agreement, whereas companies enjoying a full or a nearly full tax holiday at cantonal and federal tax level should not qualify (a careful examination on a case-by-case basis is foreseen).

On 27 January 2006, the FTA announced that the Swiss anti-abuse rules (BRB 1962 and the respective executive regulations) shall also apply to dividend, interest and royalty payments which are subject to art 15 of the Swiss-EU Savings Tax Agreement. Looking strictly at the wording of the

Swiss anti-abuse rules, these typically refer to the proper application of the Swiss double tax treaties and not to other international agreements signed by Switzerland. The FTA has though based its above interpretation on the spirit and purpose of these rules, extending their scope to art. 15 of the Agreement.
-- Anna-Maria Widrig Giallouraki and Armin Marti, Switzerland; armin.marti@ch.pwc.com

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ABOUT THE EUDTG

The EUDTG is one of PricewaterhouseCoopers' Thought Leadership Initiatives and part of 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 Member States, most of the EFTA countries and Switzerland. See the EUDTG website for more information: www.pwc.com/eudirecttax.

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 56 88).

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