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ECJ CASES

Belgium – A-G opinion on tax treatment of inbound dividends: Kerckhaert and Morres v Belgian Government case (C-513/04)

On 6 April 2006, A-G Geelhoed concluded that Article 56 EC (free movement of capital) does not prohibit Belgian legislation, which subjects dividends from resident and non-resident companies to the same uniform income tax rate, without providing for a credit for foreign dividend withholding tax.

In the case at hand, Mr and Mrs Kerckaert-Morres, two Belgian resident individuals, received a dividend from a French resident company. According to French tax law, an imputation credit ("avoir fiscal") of 50% was granted with respect to the dividend. A 15% French withholding tax was levied on both the dividend and the imputation credit. Mr and Mrs Kerckaert-Morres declared the dividend in their Belgian income tax return and claimed a tax credit for French dividend withholding tax. The dividend was taxed according to Belgian tax law at 25% and the foreign tax credit was refused. The Belgian referring court wished to know whether this refusal constitutes an infringement of Article 56, paragraph 1, EC.

Firstly, the A-G points out that the Belgian 'internal' tax rules principally treat domestic and foreign dividends similarly: both dividends are faxed at a rate of 25%. Furthermore, the A-G is of the opinion that foreign dividends are not taxed in a more burdensome way when compared to domestic dividends, provided that the French "avoir fiscal" is taken into account. If the French "avoir fiscal" is left out of consideration, French-sourced dividends are taxed in a more burdensome way than Belgian-sourced dividends. However, according to the A-G, even in that situation there is no breach of EU law. The mere fact that Belgium did not provide for a relief for juridical double taxation on dividends is not in itself contrary to Articles 43 or 56 EC, as long as Belgium complies with the obligation not to discriminate between foreign-source and domestic source dividends in exercising its right to tax. The fact that Belgium does not grant a credit for French dividend withholding tax is a consequence of a lack of harmonisation in the field of the avoidance of double international juridical taxation and the co-existence of different tax systems under EU law at its present stand. See EUDTG Newsalert NA 2006 – 10.
-- Laurens Narraina, Belgium; laurens.narraina@pwc.be

France – A-G opinion on tax treatment of outbound dividends: Denkavit v French Minister of Economic, Financial and Industrial Affairs case (C-170/05)

On 27 April 2006, A-G Geelhoed concluded that the French legislation which taxes dividends distributed by a French subsidiary to a parent company in another EU Member State more burdensomely than dividends distributed by a French subsidiary to a French parent company, is in breach of Article 43 EC (freedom of establishment).

Denkavit International BV (DI BV) held 99.9% of share capital of a French subsidiary Agro-Finances Sarl, (AF Sarl) which in turn held 50% of another French company Denkavit France Sarl (DF Sarl), the other 50% of DF Sarl being held directly by DI BV. In the years 1987 to 1989 (before the Parent/Subsidiary Directive was in force), AF Sarl and DF Sarl paid dividends of 14.5 million French Francs to DI BV, from which 5% French withholding tax was deducted, in accordance with French domestic tax law and the Dutch/French double tax treaty.

The French Conseil d' Etat referred the case to the ECJ, asking whether the imposition of dividend withholding tax by France on dividends only to non-resident parent companies (including fellow members of the EU) as compared with, in almost all circumstances, the absence of French dividend withholding tax on dividends paid by similar French subsidiaries to a French parent company, was contrary to Article 43 EC (freedom of establishment). In addition, the Conseil d' Etat also asked whether the provisions of the Dutch/French tax treaty whereby a Dutch parent company was obliged to give a credit for the French dividend

withholding tax up to the corresponding level of any Dutch tax, but in practice no such ordinary credit was given by the Netherlands because the Dutch participation exemption altered the analysis.

The A-G held that the French imposition of economic double taxation on dividends distributed by a French subsidiary to its parent company in another EU Member State, compared to the absence of economic double taxation on such dividends distributed to a French parent company was contrary to Article 43 EC and incapable of justification.

In addition, the A-G considered that if, in practice, the provisions of the Dutch/French tax treaty did not remove the economic double taxation, then the existence of the hypothetical ordinary tax credit in the Dutch/French double tax treaty would not obviate the fact that France had unjustifiably breached Article 43 EC in failing to remove the economic double taxation. See EUDTG Newsalert NA 2006 – 11.
-- Peter Cussons and Franck Le Mentec; France; franck.lementec@fr.landwellgobal.com

Germany – Second hearing in Meilicke case (C-292/04) on 30 May 2006

A-G Tizzano had in his opinion as of 10 November 2005 in the Meilicke case (C-292/04) regarding the tax treatment of foreign dividends in Germany under the former imputation system, suggested that a temporal restriction (reported on in EUDTG Newsalert NA 2005 – 13) should apply to the ECJ's judgment. This was due to the grave financial consequences that the German government had stated, should the judgment be retroactively applicable without limitation, and to the uncertainty in the application of Community Law.

By reason of the importance of the question of a temporal restriction of the ECJ judgment, the first Chamber of the ECJ decided to refer the case to the Grand Chamber. In such situations, a reopening of the hearing is ordered.

The Grand Chamber has accordingly ordered a reopening of the hearing, which will take place on 30 May 2006. The parties have been requested to comment on what the consequences of a temporal restriction in the Meilicke judgment would be, taking into account that the ECJ has already given a judgment on national legislation such as the one in question in the present case (Manninen C-314/02) and this judgment was not limited in its application. Moreover, the parties were requested to comment on the financial consequences that were the basis for the application for a temporal limitation of the judgment.
-- Caroline Naumburg and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Italy – ECJ judgment on registration duty upon downstream merger: Aro Tubi Filiere S.p.A v Italian Minister of Economic and Financial Affairs case (C-46/04)

On 30 March 2006, the ECJ decided that the Italian levy of registration duty upon downstream mergers is in conflict with the Directive regarding indirect taxes on the raising of capital (69/335/EEC).

Aro Tubi Filiere S.p.A. ("Aro Tubi") is a company limited by shares incorporated under Italian law, its entire share capital being held by another company limited by shares incorporated under Italian law, Fratelli Gaggini S.p.A. ("Fratelli Gaggini"). Aro Tubi, in turn, held the entire capital of a third company limited by shares incorporated under Italian law, Aro Tubi Estrusi e Profilati S.p.A. ("Aro Tubi Estrusi").

In December 1995 Aro Tubi acquired by merger, its subsidiary Aro Tubi Estrusi (upstream merger). At the same time, Aro Tubi acquired its parent company Fratelli Gaggini (downstream merger). Aro Tubi thus acquired the assets and liabilities of Fratelli Gaggini which included buildings, patents and trade marks. In return, all of Aro Tubi's shares were transferred to Fratelli Gaggini's shareholders.

In 1996, Aro Tubi had to pay, in virtue of merger transactions executed, registration duty equal to 1% of the assets and liabilities of the two companies which it acquired.

Aro Tubi requested, the reimbursement of registration duty paid upon the downstream merger, challenging the applicability of the duty by virtue of the provisions of the Directive on indirect taxes on the raising of capital. Subsequent to two contrasting judgements by Lower Tax Courts, the Supreme Court made a reference to the ECJ (C-46/04) to inquire if the Directive precludes the proportional registration duty in the case of a downstream merger.

The ECJ established that the Italian proportional registration duty of 1% upon downstream mergers qualified as a capital duty as meant in the Directive. Under certain conditions, the Directive (considering the subsequent evolutions of the same), guarantees a full exemption from any capital duty for transactions executed starting from 1 July 1984. In particular, the exemption is granted if a merger met three conditions: (I) the transfer of all the assets and liabilities of a capital company, or one or more parts of its business, to one or more capital companies which are in the process of being formed or which are already in existence; (II) the consideration consists exclusively of the allocation of shares; (III) the effective centre of management or the registered office of the companies taking part in the transaction is within the territory of a Member State. The ECJ verified that, in the case at hand, the above-mentioned conditions were met and concluded that, in circumstances such as those at issue in the main proceedings, the Directive 69/335/EEC precludes the charging of a proportional registration duty of 1% of the value of the transaction.
-- Claudio Valz, Italy; claudio.valz@studiopirola.com

Italy – Referral to ECJ regarding taxation of EEC contributions: Porto Antico di Genova case (C-427/05)

In a reference on 31 January 2005, the Regional Tax Court of Genoa requested the ECJ to decide on the compatibility of Italian law, pursuant to which any financial contributions (including those coming from the EU) are subject to income tax, with Article. 21(3) of Council Regulation (EEC) No 2082/93, of 20 July 1993, which says that the payment of EEC contributions will be made to the final beneficiaries without any deduction or retention, as this could reduce the amount of financial assistance to which they are entitled.

In the main proceedings, an Italian company had received financial contributions from the European Regional Development Fund. These EEC contributions are partially granted by EU bodies and for the remaining part by domestic regional entities. According to Italian tax law, the company had to include the contributions in its taxable income. However, the company held that the income tax paid on the contributions reduces the actual amount of the financial assistance granted and therefore requested to be reimbursed by the Italian Tax Authorities for having paid undue taxes with reference to Art. 21(3) of the Council Regulation.

The Italian Tax Authorities dismissed this request arguing that the Regulation expressly prohibits deductions or taxes at source in respect of EEC contributions, yet without hindering the subsequent levying of Italian income tax. According to the Tax Authorities, a different interpretation of the EU provision would lead to an infringement of Article 87 EC, given that the tax exemption would result in an unjustified State aid which would benefit only the beneficiaries of the EEC contributions and not the beneficiaries of the domestic contributions.

The Regional Tax Court referred the case to the ECJ for a preliminary ruling asking whether the levying of income tax on EEC contributions is incompatible with Article 21(3) of the Regulation; and, if the answer is in the affirmative, whether the prohibition applies to the EEC contributions granted by EU bodies only or also to those granted by domestic regional entities.
-- Claudio Valz, Italy; claudio.valz@studiopirola.com

Italy – A-G opinion on IRAP as VAT and temporal restriction: Banca Populare di Cremona v Entrate Ufficio Cremona case (C-475/03)

IRAP is an Italian tax levied on companies, partnerships and individuals, introduced in Italy in 1998. The ordinary tax rate is equal to 4.25%. IRAP is levied on an amount calculated by deducting production costs from the sales value but excluding principally labour costs. In 1999, an Italian bank (Banca Popolare di Cremona), requested a reimbursement from the Italian Tax Authorities of the IRAP paid, arguing that the tax was unlawful, because it was contrary to the Article 33 of the Sixth VAT Directive. The Cremona Tax Court referred the case to the ECJ (C-475/03).

On 17 March 2005, A-G Jacobs opined that IRAP must be characterised as a turnover tax prohibited by Article 33 (1) of the Sixth VAT Directive. The A-G stated that there were strong arguments for limiting the temporal effects of the ECJ decision and he suggested reopening the oral procedure to hear all arguments on the issue.

Following the second oral hearing, A-G Stix-Hackl issued her opinion on 14 March 2006, in which she substantially confirmed the incompatibility of IRAP with VAT.

The A-G also considered that a temporal limitation on the effects of the judgement is justified and suggested that the judgement should take effect at the end of the tax period during which the Court issues its judgement (if a judgement is delivered this year it would take effect as of the end of 2006). According to the A-G's opinion an exception to this temporal limitation should be made for all those who had commenced legal proceedings for reimbursement prior to the delivery of the A-G's opinion on 17 March 2005 (date of delivery of the first opinion on the IRAP case).

The A-G also took into consideration the possible consequences for other Member States. See EUDTG Newsalert NA 2006 – 07.
-- Claudio Valz, Italy; claudio.valz@studiopirola.com

Netherlands – A-G opinion on Dutch legislation on emigration of substantial shareholders: N v Tax Inspectorate East/Almelo case (C-470/04)

On 30 March 2006, A-G Kokott opined that neither Article 18 EC nor Article 43 EC preclude an exit levy as follows from Dutch tax legislation provided that the assessed tax is deferred until the actual disposal of the shares and the tax levied upon the actual disposal following emigration is not higher than the tax which would have been levied on disposal within the territory.

Mr N. left the Netherlands on 22 January 1997 in order to settle in the UK. As from 2002, Mr N. had exploited in the UK a farm with an apple tree orchard. As at the date of emigration, Mr N. held 100% of the shares in three Dutch BVs (limited liability companies), as from the date mentioned tax residents of the Dutch Antilles. For Dutch personal income tax purposes, these shares qualified as a substantial shareholding and were deemed to be disposed of as a result of his emigration. Dutch personal income tax was due on the market value of the shares minus their acquisition price. Based on the Dutch Law Mr N. applied for a suspension of the tax payment for a period of ten years. The request for a suspension of payment was granted conditionally upon Mr N. granting guarantees sufficient to ensure recovery of the tax. To be in accordance with this condition, Mr N. granted a pledge in favour of the Dutch tax authorities. Based on the judgement of the ECJ in De Lasteyrie du Saillant (C-9/02) the Dutch tax authorities informed Mr N. the pledge could be considered released.

Mr N. first raised an objection against the tax assessment on the deemed disposal and then brought an appeal before the Regional Court of Appeal of Arnhem arguing that the levy of taxes as a result of the deemed disposal of the shares due to his emigration within the EU, is in breach of EU law. The court requested the ECJ for a ruling. Asking to the possible incompatibility of the tax assessment with Articles 18 and 43 EC and the consequences of the retroactive release of the security provided.

The A-G is of the view that Article 43 EC is not applicable for the sole reason that the emigrating resident owns shares in a company. Furthermore, the AG addresses the question whether the economic activities established years after the transfer of residence give the resident the right to rely on Article 43 EC. According to the A-G this question can be answered in the affirmative if, at the point in time at which this fundamental freedom is relied on, there is specific evidence that it is foreseeable that appropriate economic activity in the other Member State will be taken up.

The A-G opines that a resident may rely against his home State on Article 18 EC if the serving of a tax assessment linked with his departure subjects him to a disadvantage compared to domestic taxpayers who have not exercised their right to free movement.

With regard to the possible infringement of Articles 18 and 43 EC, the A-G argues that these articles do not preclude a provision of a Member State such as under discussion provided the following conditions are met: (i) the assessed tax is deferred until the shares are actually disposed of without any further conditions being met, and (ii) it is ensured that the tax in fact levied on a disposal following emigration is not higher than the tax which would have been levied on disposal within the territory assuming all other circumstances to be the same. Currently, the Dutch rules are in line with these conditions. See EUDTG Newsalert NA 2006 – 08.
-- Jan Gooijer and Frank Engelen, Netherlands; jan.gooijer@nl.pwc.com

Netherlands – Referral to ECJ on regime for Fiscal Investment Funds (No. 40.037)

On 14 April 2006, the Dutch Supreme Court referred preliminary questions to the ECJ with respect to the Dutch tax regime for fiscal investment funds. These include the questions to what extent is a Netherlands resident fiscal investment fund entitled to a credit for foreign tax and the interpretation of the 'standstill' clause of Article 57 EC and the scope of Article 56 (free movement of capital) with respect to third countries.

X BV is a tax resident of the Netherlands and qualifies as a fiscal investment fund for corporation tax purposes, which means that X BV is subject to corporate income tax at the rate of 0%. The activities of X BV include the active and professional management of minority shareholdings in companies whose shares are quoted on an European stock exchange. X BV's shareholders include both individuals and companies residents of the Netherlands, EU Member States and third countries. In the book year at issue, 1997/1998, X BV has received dividend payments from foreign companies upon which foreign dividend tax has been levied. The tax inspector has refused to grant a credit for German and Portuguese dividend withholding tax. X BV contends that this refusal is a restriction of the free movement of capital.

If a fiscal investment fund receives a dividend from a Netherlands resident company which has withheld Dutch dividend tax, the Dutch dividend tax is refunded (full credit). Foreign dividend tax, however, is only refunded to the extent that X BV's shareholders - therewith ingnoring the investment fund - would have been entitled to a credit for foreign tax (under tax treaties or unilateral rules for the avoidance of double taxation) in case of a direct investment. Generally only an ordinary credit would be available for shareholders tax resident in the Netherlands. X BV contends that this differential treatment is not in line with EU law (Articles 56 and 58 EC). The Supreme Court has decided to refer this matter to the ECJ, thereby distinguishing between dividends received from EU and third country resident companies.

X BV has also argued that its minority shareholdings in third country companies are not covered by the standstill clause of Article 57 EC, since these do not qualify as a "direct investment" within the meaning of the said Article. This question has also been referred.

Finally, the Supreme Court has asked whether it is relevant i) that the foreign withholding tax on the dividend for which a credit is asked may be higher than the Netherlands dividend withholding tax on the subsequent distribution by the fiscal investment fund, ii) that the State of residence of the fiscal investment fund's shareholders has concluded a tax treaty with The Netherlands which provides for a tax credit for Netherlands

withholding tax, and iii) these shareholders have their fiscal residence in an EU Member State. See EUDTG Newsalert NA 2006 – 03.
-- Frank Engelen, Netherlands; frank.engelen@nl.pwc.com

UK – A-G opinion on UK legislation on intercorporate foreign dividend income: Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue case (C-446/04)

On 6 April 2006, A-G Geelhoed concluded that UK taxation of intercorporate foreign dividends is contrary to Article 43 EC (freedom of establishment) or Article 56 EC (free movement of capital).

The Test Claimants in the UK FII GLO are claiming that the UK's taxation of intercorporate foreign dividend income from companies resident elsewhere in the EU, as compared with exemption of UK to UK intercorporate dividend income, is contrary to Article 43 or Article 56 EC and incapable of justification.

In addition, the claimants claim that the now repealed UK Advance Corporation Tax (ACT) system (and by implication the continuing shadow ACT regime) are contrary to Articles 43 or 56 EC, insofar as dividends from EU non-UK companies cannot constitute Franked Investment Income ("FII") capable of reducing the recipient UK resident company's liability to ACT (on distributions prior to 6 April 1999) or shadow ACT (on dividends after 5 April 1999 for those groups still with surplus ACT then).

The claimants also contend that the inability to surrender surplus ACT to an EU non-UK resident subsidiary constitutes a separate breach of Article 43 EC.

Furthermore, the claimants contend that the 1994 to 1999 foreign income dividends ("FID") regime, in requiring ACT on a FID to be paid 14 days after the end of the relevant calendar quarter in which the dividend was paid, and only being repaid when mainstream corporation tax was due, was a further breach of Articles 43 or 56 EC.

The A-G's opinion is in favour of the claimants on all of the above points. Only in relation to the claimant's contention that the Article 57 EC standstill provision should not be available in respect of the 1994 FIDs regime did the A-G recommend that the ECJ rule against the claimants. Moreover, as regards third country portfolio dividends on shareholdings which do not give the shareholder "lasting and direct links" with the investee company, the A-G opined that Article 57 EC standstill relief would not be available, hence taxation of such dividends would appear to be in breach of Article 56 EC, albeit potentially capable of justification. See EUDTG Newsalert NA 2006 – 09.
-- Peter Cussons, United Kingdom; peter.cussons@uk.pwc.com

UK – A-G opinion on UK CFC legislation: Cadbury Schweppes plc and Cadbury Schweppes Overseas Limited v CIR UK Controlled Foreign Company case (C-196/04)

On 3 May 2006, A-G Léger concluded that the UK CFC legislation is contrary to Article 43 EC (freedom of establishment). CFC legislation can only be justified if it just catches "wholly artificial arrangements".

CS plc had set up two Irish subsidiaries, CS Treasury Services (CSTS) and CS Treasury International (CSTI) benefiting from the 10% Irish IFSC rate to carry out a sterling and dollar treasury activity, including raising additional third party funds for group use.

The UK Special Commissioners (SCs) referred to the ECJ the question: "Do Articles 43 and 48 (Freedom of Establishment), 49 (Services) and 56 (Free Movement of Capital) of the EC Treaty preclude national tax legislation such as that at issue in the main proceedings, which provides in specified circumstances for the imposition of a charge upon a company resident in that member state (the UK) in respect of the profits of a subsidiary company resident in another member state (Ireland) subject to a lower level of taxation?"

The A-G has opined that first, the establishment by an EU parent company of a subsidiary in another Member State for the purpose of enjoying a more favourable tax regime in that other Member State does not, in itself, constitute an abuse of freedom of establishment, preventing access to freedom of establishment.

Secondly, the A-G considers that the UK CFC legislation does hinder the freedom of establishment, notwithstanding that the overall tax rate (10% Irish tax plus 20% incremental UK tax) is the same as the 30% UK corporation tax rate, had CS plc set up the relevant treasury subsidiaries in the UK. In so doing, he focuses not only on the absence of UK tax on dividends from UK subsidiaries paid to CS plc, but also on the fact that the UK CFC regime only applies where the foreign subsidiary is subject to a rate lower than ¾ of the UK tax that such a subsidiary would have been subject to if in charge to UK corporation tax, which excludes some foreign subsidiaries with a rate lower than the UK, but not others.

Thirdly, he considers that whether or not a Member State can justify application of its CFC legislation to a particular tax payer should be evaluated by reference to whether or not the CFC regime only catches "wholly artificial arrangements". That in turn depends on whether the subsidiary is engaged in the actual pursuit of an economic activity in the Host State. See EUDTG Newsalert NA 2006 – 12.
-- Peter Cussons, United Kingdom; peter.cussons@uk.pwc.com

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NATIONAL DEVELOPMENTS

Germany – Draft legislation on reorganisations: corporate and tax law

On 13 February 2006, the German Federal Ministry of Justice presented a proposal for a draft bill concerning changes of the German Reorganisation Act, which was submitted to the business associations and professional committees for comments. The reason for the proposal was to implement Directive 2005/56/EC on cross-border mergers of limited liability companies and to meet the requirements of the ECJ judgment in the SEVIC case (C-411/03). Even though the Directive only needs to be implemented as of December 2007, an earlier implementation was preferred by industry; it is thus suggested that the bill becomes effective on the day after promulgation. Once in force, the bill enables companies to legally merge cross-border.

Furthermore, the Federal Ministry of Finance issued a proposal for a draft bill concerning accompanying tax measures for the implementation of the Societas Europaea (SE) and changes of other Tax Acts on 21 April 2006. The proposal was submitted to the business associations and professional committees for comments. After the consultation procedure, a draft bill will be introduced to the parliament.

The proposal seeks to implement the Merger Directive 90/434/EEC and 2005/19/EC. Apart from that, it inter alia submits a revised exit tax for individuals in respect of qualifying participations. The European Commission had initiated Art. 226 EC procedures against Germany in respect of the current exit tax for individuals. The proposal suggests an assessment of the capital gain upon exit out of Germany, but an interest free deferral of the tax until the participation is actually disposed of.

The proposal further contains changes of basic principles and clarification of case law: The general rule will be that when assets exit the German taxing jurisdiction, there will be a deemed disposal. When assets enter the German taxing jurisdiction, their value for tax purposes will correspond to the tax value in the other State upon exit of the assets from that taxing jurisdiction, capped at market value. If there was no exit tax in the other State, the assets will be carried at book value when entering the German taxing jurisdiction. Reorganisations (both domestic and cross border) will generally be carried out at market value, i.e. with taxation. As an exception, reorganisations can be carried out at book value provided that Germany does not lose its right to tax gains in the assets/shares after the reorganisation. The transfer of registered office of a SE will be tax neutral where the assets taxable in Germany pre transfer are left in a permanent establishment in Germany and thus equally taxable post transfer. Foreign equivalents to mergers, divisions and partial divisions

and transformations will as such be included in the Reorganisation Tax Act. Carried forward losses in a transferring company will disappear upon merger both in domestic as well as in cross-border cases.

The proposal envisages a tax exemption of gains or losses arising for the receiving company upon merger (both domestic and cross-border). However, 5% of such gain will be treated as non-deductible expenses insofar as it represents shares of the receiving company in the transferring company, thus resulting in only a 95% exemption. Art. 7 of the Merger Directive stipulates that gains accruing to the receiving company on the cancellation of its holding in the transferring company shall not be taxed. EU Member States may only derogate from this where the holding is less than 20% of the capital in the transferring company (as of 1 January 2007, 15% and 1 January 1, 2009, 10%). It is thus questionable if a general 5% add back, irrespective of the amount of the participation, is compatible with the Directive. Regarding divisions, the proposal requires that a *branch of activity* is transferred for the division to be tax neutral. The Merger Directive does not have this requirement for divisions, only for *partial* divisions. Also in this respect, the proposal is not in line with the Directive.

The proposal foresees changes of several other Tax Acts. It is to be expected that there will be quite a few amendments before the proposal is introduced to the parliament as a draft bill.
-- Caroline Naumburg and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Netherlands – Supreme Court judgment on extension of the Bosal case to third countries (case 41 815)

On 14 April 2006, the Dutch Supreme Court held that the non-deductibility of expenses incurred in connection with participations in third countries is compatible with Article 56 EC (free movement of capital).

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 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 on the basis of article 13, paragraph 1 of the Dutch Corporate Income Tax Act.

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 are prohibited. The Dutch tax authorities disagree with this view and argue – amongst others – that the standstill clause of Article 57 EC applies. The Regional Court of Appeal was of the view that the non-deductibility does not constitute an infringement of the free movement of capital. The Supreme Court shared this view.

The Dutch Supreme Court starts its line of reasoning by stating that it is undisputed that the investments constitute capital movements to third countries that can be qualified as ‘direct investment’ in the meaning of Article 57, paragraph 1 of the EC Treaty. Although this is not mentioned explicitly, this is probably because the holding company owned majority shareholdings (87.09% - 100%). In addition, the Supreme Court states that there is no discussion that the refusal to deduct the expenses constitutes an infringement of Article 56 EC.

Subsequently, the Supreme Court held that the standstill provision of article 57, paragraph 1 EC must be examined in the light of the specific case at hand. The restriction in this specific case is caused by the Dutch provision as it was applicable on 31 December 1993 and is not affected by the change of the provision afterwards.

Secondly, the Supreme Court held that the relevant capital movements *in this specific case* only constitute capital movements that can be qualified as capital movements as meant in Article 57, paragraph 1 EC. The

fact that article 13, paragraph 1 Dutch CITA might also affect capital movements that cannot be qualified as one of the categories as meant in Article 57, paragraph 1 EC is therefore not relevant in this case.

Finally, the Supreme Court held that the provision on the freedom of establishment in the Association Agreement between the European Communities and Poland does not apply to the limitation of the deduction of the expenses incurred in relation to the 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 and does not aim at the abolition of restrictions in the Netherlands where a Dutch company wants to establish in Poland.
-- Frank Engelen and Cees Peters, Netherlands; frank.engelen@nl.pwc.com

Netherlands – Reduction of dividend withholding tax rate

On 24 April 2006, the Dutch State Secretary of Finance announced in a press release that the Dutch dividend withholding tax rate will be reduced from 25% to15%. The new tax rate will probably be effective as from 1 January 2007.

A few months ago the Dutch State Secretary of Finance had already suggested that in the next couple of years the Dutch dividend withholding tax could be gradually abolished and that in anticipation thereof the dividend withholding tax rate would be reduced. The change will be part of the revision of the Dutch Corporate Income Tax Act 1969. It is inspired by the aim of the Dutch government to improve the Dutch corporate income tax regime which should attract additional business to the Netherlands. No doubt that the developments in the case law of the ECJ in the field of dividend withholding tax will also be an important catalyst for future changes in the Dutch dividend withholding tax act.
-- Cees Peters, Netherlands: cees.peters@nl.pwc.com

UK – High Court judgement in the case of Marks and Spencer plc v Halsey (C-446/03) following the ECJ's judgment on 13 December 2005

On 10 April 2006, Justice Park gave his judgment in the UK High Court in the case of Marks and Spencer (M&S) plc v Halsey, following the ECJ's judgment in case on 13 December 2005. The judge held that M & S plc did not succeed as regards losses of M & S (France) SA, as it has been orally confirmed that M & S (France) SA losses have been or will be used by Galeries Lafayette SA. Moreover, the judge held that the so-called "wider view" of the ECJ M & S judgment was not correct but rather that the UK restriction on group relief not being available for losses of non-UK resident subsidiaries not trading in the UK to a permanent establishment should only be disapplied where the ECJ judgment Paragraph 55 conditions were met (losses not being used locally).

The "wider view" is that, if, on the facts, a taxpayer demonstrates that the UK Group relief rules were disproportionate, then until the law is changed all cross-border claims must succeed as the
Paragraph 55 conditions cannot be retrospectively "read down" into UK domestic legislation.

The judge did not however deal with or distinguish the UK Court of Appeal judgment in Fleming (trading as Bodycrafts Limited), which held that the circumstances in which UK legislation can be "read down" consistently with an ECJ judgment are very narrow.

In relation to the losses of M & S (Belgium SA) and M & S (Deutschland) GmbH, the judge held that the test was whether all recognised possibilities legally available given the objective facts for local loss relief had been extinguished at the time the group relief claim was made.

M & S plc are applying to the UK Court of Appeal for leave to appeal against the High Court judgment.

Irrespective of whether leave to appeal is granted, the High Court has remitted the case to the Special Commissioners for determination of whether on the High Court test the losses of M & S (Belgium) SA and/or M & S (Deutschland) GmbH are available for group relief on the facts.

The High Court has granted 6 weeks in relation to the leave to appeal to the UK Court of Appeal.

No order has been made as to costs at this stage
-- Peter Cussons, United Kingdom; peter.cussons@uk.pwc.com

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EU DEVELOPMENTS

Malta and the European Union: Agreement on amendments to the Maltese tax system

Malta and the EU have been discussing certain elements of Malta's tax system, and in particular those that relate to international business, for some time. During the course of these discussions, both sides have made a number of proposals designed to allay any concerns that the EU may have in this respect.

The European Commission announced on 23 March 2006 that agreement had been reached with Malta to introduce a number of amendments to the current tax system which, in effect, would result in the extension of the "refundable tax credit system for all companies distributing their revenues as dividends to their shareholders, both resident and non-resident, regardless of their legal form or status, the business activity exercised, their size, sector, and the source and type of the income derived by the companies." The announcement recognises that the proposals, "although still advantageous for foreign investors", would not be selective.

The EU has asked Malta to introduce the new system for all existing companies by the end of 2010 and for any new companies by 1 January 2007.

It is not expected that the impact of any of the proposals will be significant on existing international business located in Malta or on any prospective users of Malta as a base for their international activities.

On the assumption that Malta accepts the proposed EU timetable as set out above, it is expected that this agreement will lead to an increase in the interest in utilising Malta by foreign investors, given the degree of certainty that will then exist.
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European Commission issues Communication on progress and next steps on the Common Consolidated Corporate Tax base

On 5 April 2006, the European Commission published a progress report on the work done on the Common Consolidated Corporate Tax Base (CCCTB) stating that encouraging progress has been made to-date by the Commission-led technical expert working group. However, it adds that at the same time a stronger commitment and more flexibility is required from more Member States to be able to present a comprehensive legislative proposal on CCCTB to Parliament and Council in 2008. In its Communication, the Commission draws the following main conclusions:

- The CCCTB should be simple and uniform with as few as possible exceptions;
- The tax base should be consolidated and optional for companies;
- The rules for calculating the CCCTB should be self-standing and not formally linked to the international accounting standards (IAS/IFRS);

- The current approach of working in close cooperation with Member States experts, business and academia is the most effective.

In terms of next steps, the work of the first four sub-groups (on Assets and Depreciation; Provisions, Reserves and Liabilities; Taxable Income; and International Aspects) should be broadly completed by the end of 2006. Work will also start soon on consolidation, the sharing mechanism for the CCCTB and the structural and legal framework which covers the administrative framework, audit arrangements, legal interpretation and court procedures. The next Commission progress report is planned for the beginning of 2007.
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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 5688).

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