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CONTENT

ECJ Cases

Belgium — ECJ judgement on Belgian Coordination Centre regime (Belgium and Forum 187 ASBL v Commission)
Denmark — A-G opinion on tax treatment of payments to life insurance and pension insurance schemes of foreign pension institutions (Commission v. Denmark)
Finland — A-G opinion on Finnish rules on taxation of non-resident pension income (Turpeinen case)
Finland — Referral to ECJ on Finnish transfer tax
France — Referral to ECJ on the 3% tax on real estate applied to a Luxembourg holding company
Germany — Referral to ECJ on valuation of estate for German Inheritance Tax purposes
Germany — Referral to ECJ on corporation tax uplift on distributions to non-resident shareholders (Burda Verlagsbeteiligungen case)
Germany — A-G opinion on liability for withholding tax on payments to non-residents (FKP Scorpio Konzertproduktionen GmbH case)
Germany — A-G opinion on write-downs on foreign participations (Rewe Zentralfinanz eG)
Germany — A-G opinion on deductibility of business expenses for non-residents (Centro Equestre da Leziria Grande Ltd case)
Germany — Referral to ECJ on the non-deductibility of foreign currency losses in respect of foreign exempt permanent establishments (Deutsche Shell case)
Italy — ECJ judgement on the administrative charge (Commission (of EC) v Italy case)
UK — A-G opinion on UK thin cap legislation (Test claimants in the Thin Cap group litigation v Commissioners of Inland Revenue case)

National Developments

Germany — Federal Tax Court judgement on transitional rules applying only to foreign shares in 2001
Netherlands — A-G opinion on dividend withholding tax on outbound dividends
Netherlands — Substantial revision of the Corporate Income Tax Act
UK — New legislation to allow relief for certain EEA losses
UK — Consultation on UK taxation of foreign profits

EU Developments

Italy — Italy referred to ECJ by the EC over its "golden share" rules (AEM S.p.A. case)
EU — Council adopts code of conduct on transfer pricing documentation for associated enterprises

ECJ CASES

Belgium – ECJ judgement on the Belgian Coordination Centre regime: Belgium and Forum 187 ASBL v Commission (joined Cases C-182/03 and C-217/03)

On 22 June 2006, the ECJ delivered its judgment on the Belgian coordination centre regime case whereby it partially annulled the European Commission's decision of 17 February 2003 which ordered the gradual phase-out of the Belgian Coordination Centres until 31 December 2010. Coordination Centres that benefited 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.

The Belgian Government and Forum 187 (i.e. Association of the Belgian Coordination Centres) immediately launched a case before the ECJ to either completely or in part annul the Commission's decision. On 26 June 2003, the President of the ECJ ordered that the operation of the decision be suspended in so far as it prohibited Belgium from renewing Coordination Centre authorisations effective as from the date of notification of the decision.

The ECJ has upheld the position of the Commission that the Belgian legislation is State aid incompatible with EC law. However, the ECJ has partially annulled the Commission's decision in order to allow for an adequate period of transition. The ECJ held that Coordination Centres with an application for renewal pending on the date on which the Commission's decision was notified or with a recognition which expired at the same time as or shortly after the decision was notified, had legitimate expectations to receive a reasonable transitional period in order to adjust to the consequences of the Commission's decision. The ECJ also opined that the Commission by failing to adopt transitional measures for those Coordination Centres with an authorisation which expired at the same time or shortly after the notification of the Commission's decision infringed the general principle of equal treatment.
See EUDTG Newsalert NA 2006 – 17.
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Denmark - A-G opinion on tax treatment of payments to life insurance and pension insurance schemes of foreign pension institutions: Commission v. Denmark (C-150/04)

On 1 June 2006, A-G Stix-Hackl concluded that the Danish tax rules denying deductibility for payments into life insurance and pension insurance schemes of pension institutions established in another EU Member State were in conflict with Articles 39, 43, 49 and 56 of the EC Treaty.

In 2004, the European Commission brought an action against Denmark. The Commission declared that Denmark has failed to fulfil its obligations under the EC Treaty by introducing and maintaining a system for life insurance and pensions under which tax deductions and tax exemptions are granted only for payments under contracts entered into with pension institutions established in Denmark, whereas no such tax relief is granted for payments pursuant to contracts entered into with pension institutions established in other Member States.

The A-G has concluded that the relevant Danish tax rules can neither be justified by the need to ensure effective fiscal supervision, nor by the need to preserve the coherence of the national tax system, as set out in the *Bachmann case (C-204/90).*
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Finland – A-G opinion on Finnish rules on taxation of non-resident pension income: Turpeinen case (C-520/04)

A-G Léger released on 18 May 2006 his opinion in the Turpeinen case concerning Finnish withholding taxation in relation to free movement of persons (Art. 39 EC) and the right of citizens of the EU to move freely within the territory of the Member States (Art. 18 EC).

Mrs. Turpeinen, a Finnish national living abroad (first in Belgium and then in Spain) since 1998, was considered non-resident for Finnish tax purposes as from 2002. In 2002 her worldwide income consisted only of Finnish-source pension payments from her earlier public service. The Finnish – Spanish tax treaty assigned taxing rights on this income to Finland. Under Finnish law, such earned income received by non-residents was taxed at the flat rate of 35 %, whereas residents were taxed at progressive rates between 0 - 55 %. In fact, Turpeinen had in 1999-2001, when still considered resident for Finnish purpose, been levied taxes at 28.5 % on the same income.

The A-G opined that neither Directive 90/365/EC, Art. 10 of Regulation 1408/71 nor Art. 39 EC applied to this case. Accordingly, the case should be analyzed from the perspective of Art. 18 EC and following the so-called "Schumacher-rule" the A-G concluded that the Finnish rules should be found to breach Art. 18 EC to the extent that they impose a heavier tax burden on non-residents (like Turpeinen) who have received all or a significant part of their income from Finland. According to the A-G, the breach could not be justified by the fact that the withholding procedure was there to secure a simplified regime for non-residents or by the effectiveness of fiscal controls. Meanwhile, the relevant Finnish tax provisions have changed as from 2006.
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Finland - Referral to ECJ on Finnish transfer tax (KHO 2006:32)

On 26 May 2006, the Finnish Supreme Administrative Court (Korkein Hallinto-oikeus, KHO) referred a preliminary question to the ECJ with respect to the Finnish transfer tax levied on share-for-share transactions. The preliminary question covers the possible infringement of the transfer tax of Article 56 EC and Article 12(1)(c) of the EU Directive on the raising of capital (69/335/EEC).

Shares in a Finnish resident company D Oy are to be transferred to Luxembourg resident X SA by its current parent company, Finnish resident Y Oyj. The transfer would be executed as an exchange of shares, i.e. Y Oyj will make a contribution in kind (the shares in D Oy) to X SA's share capital in exchange for shares in X SA. According to the Finnish Transfer Tax Act, transfer of ownership in Finnish shares triggers transfer tax liability for the acquirer. X SA appealed its case all the way to the KHO, which decided to stay the proceedings and refer the case to the ECJ for a preliminary ruling.

The underlying question of the case seems to be the civil law clarification of the transactions and what is actually seen to be the basis for transfer taxation. The lower level Administrative Court (and the Finnish Ministry of Finance) stated that the transfer tax is payable due to the *transfer of ownership* of the shares in D Oy, not due to share capital increase in X SA. Thus, the transfer tax is actually levied in accordance with Article 1(c) of Directive 69/335/EEC and not violating the Article 12(1)(c) of the same Directive. On the other hand, X SA has argued that from its point of view the transaction is clearly an increase of share capital by contribution in kind. The transaction leads directly to an increase of X SA's share capital corresponding to the value of the shares received.

Taking into account the purpose of the Directive 69/335/EEC and especially the wording of Article 12(1)(c), transfer tax may not be levied.
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France – Referral to ECJ on the 3% tax on real estate applied to a Luxembourg holding company

In France, a 3% tax applies to companies which hold real estate located in France. This 3% tax is based on the fair market value of the real estate. However, this tax is not due notably if (i): the company is located in a country with which France has signed an administrative assistance agreement and it discloses in due time the holding of the real estate, or (ii) France and the country in which the company is located have signed a tax treaty including a non-discrimination clause.

In the present case, a Luxembourg holding company ("holding 1929") held French real estate. This Luxembourg company was not able to benefit from any exemption, since (i) this kind of holding company is excluded from the scope of the France/Luxembourg tax treaty and (ii) the France/Luxembourg tax treaty does not contain a non-discrimination clause.

In its decision of 13 December 2005, the French Supreme Civil Court referred, in broad terms, the following questions to the ECJ:

- Is the condition for the exemption, based on the application of an administrative assistance provision, compliant with the freedom of movement of capital? If this condition is viewed as compatible with the fundamental freedom, could the Directive of 19 December 1977, regarding the mutual assistance between the Member States, be considered as sufficient to avoid tax avoidance and ensure the efficiency of the tax audits? The latter question implies that the 3% tax can be qualified as a wealth tax.

- Does the freedom of establishment principle oblige a Member State which has signed tax treaties including a non-discrimination clause with other EU or non-EU States to apply such non-discrimination principle to a company located in another Member State?

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Germany - Referral to ECJ on valuation of estate for German Inheritance Tax purposes (C-256/06)

A French resident individual inherited French and German agricultural and forestry estate in 1998. As the deceased was resident in Germany at the time of death, the whole succession, i.e. both the German and the French estate, was subject to German inheritance tax. The German tax authorities partially credited the French inheritance tax against the German tax. The heir claimed a full credit of the French tax and argued that German law infringes the free movement of capital (Art. 56 EC).

The German Supreme Tax Court stated on 11 April 2006 that the German estate was subject to higher taxation in Germany, as part of the estate was situated in France and not in Germany. This is due to certain provisions in the German Evaluation Act and Inheritance Tax Act. Firstly, foreign agricultural and forestry estate is valuated at fair market value, whereas domestic estate is subject to a special valuation, which usually results in a value of about 10 % of the fair market value. Had this valuation process been applied to the French estate, no German tax had been levied on the German property in this specific case. Moreover, certain German estate also benefits from a tax

exempt amount as well as a reduction of tax base for inheritance tax purposes. The Court cited the *Barbier case (C-364/01)*, where the ECJ considered different valuations of estate based on residence of the deceased not to be compliant with EC law. It stated that since that judgement, it is questionable whether the German rules comply with the free movement of capital, as they result in a different treatment based on where the estate is situated.

The Court then analysed if Art. 58 of the EC treaty applies to the German provisions. This article allows the application of national tax provisions that distinguish between taxpayers due to the place of their investment. It thereby cited the Declaration to this article, adopted upon signature of the "Final Act and Declarations of the Intergovernmental Conferences on the European Union" in 1992. The declaration limits the Member States' right to operate national provisions which differentiate due to place of investment, to rules that existed at the end of 1993. As both the valuation procedure for domestic estates as well as the tax exempt amount and reduction in the tax base for agricultural and forestry estates were changed or respectively introduced after 1993, the Court doubted that the different treatment can be justified by Art. 58 EC. It therefore referred the case to the ECJ and asked the following question: Is it compatible with the free movement of capital to value foreign estate at fair market value, whereas domestic estate is regularly valued at 10 % of fair market value and where a tax exempt amount as well as a reduction of tax base applies to domestic estate, if this leads to a higher tax, due to the fact that the inheritance consists of both domestic and foreign estate.

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Germany - Referral to ECJ on corporation tax uplift on distributions to non-resident shareholders: Burda Verlagsbeteiligungen case (C-284/06)

On 22 March 2006, the German Supreme Tax Court referred certain aspects of the former German imputation system to the ECJ. Under the imputation system, equity of resident corporations was divided into different baskets. Baskets containing taxed equity were always used first for profit distributions. If a distribution could not be completely financed from the taxed equity baskets, baskets with non-taxed equity were subsequently utilised. Distributions from taxed equity baskets led to a corporation tax reduction and distributions paid from the non-taxed basket EK02 led to a corporation tax uplift of 3/7 of the dividend. If a distribution was made out of the taxed baskets or out of EK02, a (German resident) shareholder was granted an imputation credit, amounting to 3/7 of the dividend. The imputation credit was certified by the distributing company, which enabled the shareholder to claim the imputation credit. Non-resident shareholders were not entitled to an imputation credit.

To the extent (e.g. in a later tax audit) the taxed equity was subsequently reduced and no longer sufficient for a previous distribution, the law foresaw a utilisation of the EK02 basket. The resulting uplift of corporation tax secured that the imputation credit that had already been certified to and probably utilised by the shareholders was not financed out of non-taxed income.

In the case at hand, a German resident company had made a distribution to its German and EU resident parent companies out of taxed equity, which was subsequently reduced. EK02 was utilised, which led to an uplift of corporation tax.

The German Supreme Tax Court doubted whether the corporation tax increase is allowed under Art. 5 para. 1 of the Parent/Subsidiary Directive. It referred to the ECJ judgment in *Athinaiki Zythopoiia AE (C-294/99)* where a Greek corporation tax uplift was regarded as a prohibited

withholding tax according to Art. 5 para. 1 of the Directive, since the taxable event was the distribution and the amount of tax was directly related to this. The same applies to the EK02 tax uplift; the taxable event is the distribution and the increase of tax is directly related to the amount distributed (3/7 of the dividend).

Moreover, the Court questioned the provision stipulating a mandatory utilisation of EK02, thus deviating from the general rules of utilisation of the equity baskets. The provision should prevent that shareholders got an imputation credit where the distributed profits had, e.g. subsequent to a tax audit, finally not been taxed. As non-resident shareholders were not entitled to an imputation credit in any case, it can be doubted if this provision should apply upon distributions to such shareholders. Resident shareholders could credit the tax, but for non-resident shareholders, the corporation tax paid by the subsidiary was final. This could prevent foreign shareholders from investing in German companies and so constitute an infringement of the freedom of establishment and the free movement of capital. The Court held this treatment to be questionable at least when the distributing company can prove that the distribution was made to a shareholder who was not entitled to an imputation credit.
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Germany - A-G opinion on liability for withholding tax on payments to non-residents: FKP Scorpio Konzertproduktionen GmbH case (C-290/04)

Scorpio, a German resident company, arranged concerts in Germany. In 1993, Scorpio paid a consideration to an individual resident in the Netherlands for providing artistic performances to an individual resident in the Netherlands without deducting German withholding tax, even though no exemption certificate had been produced. The tax authorities held Scorpio liable for the withholding tax.

Under German tax law, a final withholding tax is levied on gross consideration (without deduction for business expenses) paid to non-residents on income from artistic performances. The debtor is liable for the correct withholding tax. Even if a tax treaty provides for a lower or no German tax at all, the tax must be withheld and is subsequently refunded, unless an exemption certificate is issued in advance. There is no withholding obligation and liability for payments to resident creditors. Scorpio therefore objected to the liability. The German Supreme Tax Court referred the case to the ECJ.

In his Opinion of 16 May 2006, A-G Léger stated that neither the withholding nor the debtor's liability constitutes an infringement of the freedom to provide services in the relevant year, i.e. 1993. The unequal treatment of payments to residents and non-residents was justified by the necessity of an efficient collection of taxes: Germany had in 1993 no means to impose its tax claims in the Netherlands, neither by the tax treaty nor by the directive on mutual assistance for recovery of claims. Further, provided that a deduction of business expenses is eventually granted, e.g. within a refund procedure, the levying of withholding tax on the gross consideration is compatible with the freedom to provide services. To require an advance exemption certificate in order to benefit from a tax treaty exemption is a restriction, which can be however justified on the grounds of a correct application of the withholding procedure. In contrast, the tax exemption under a treaty has to be considered in respect of the liability of the debtor. Finally, the A-G concluded that under Art. 49 EC the nationality of the EU-resident provider of the service is irrelevant for the rights of the recipient of the services. See EUDTG Newsalert NA 2006 – 13
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Germany - A-G Opinion on write-downs on foreign participations: Rewe Zentralfinanz eG (C-347/04)

On 31 May 2006, A-G Maduro opined that (former) German tax law that disallowed immediate tax deductibility for write-downs on certain foreign participations is in breach of the freedom of establishment.

Rewe Zentralfinanz, a German resident company, was the sole shareholder of a Dutch holding company with lower tier subsidiaries in other EU Member States. Rewe wrote the participation in the Dutch company down to fair market value in 1994 and 1995. The tax authorities denied a deduction, due to the fact that the participation was not active.

Under German tax law applicable at the time of the case, write-downs on resident participations were immediately tax deductible. Write-downs on non-resident participations were only immediately tax deductible if the participation was active in the sense of the relevant section in the German Income Tax Act (still in force). This section does not only apply to write-downs, but excludes immediate deduction of other negative income related to foreign business, unless the income is covered by the activity requirement. Such "passive" negative income can only be set off against positive income from the same source and from the same state.

The A-G stated that the law distinguished between write-downs on resident companies and write-downs on non-resident companies. Consequently, a company with a subsidiary in another Member State was treated less favourably than had the subsidiary been resident in Germany. Even if the loss deriving from the non-resident subsidiary could be set off against subsequent profits therein, the immediate deduction of a write-down constituted a cash-flow advantage. To deprive companies with subsidiaries in other Member States that advantage could deter German parent companies from establishing subsidiaries in other EU Member States. The treatment thus restricts the freedom of establishment (Art. 43 EC). According to the A-G, this restriction could not be justified. Finally, the A-G concluded that the free movement of capital was infringed for the same reasons. See EUDTG Newsalert NA 2006 – 14.
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Germany - A-G Opinion on deductibility of business expenses for non-residents: Centro Equestre da Leziria Grande Ltd case (C-345/04)

On 22 June 2006, A-G Léger concluded that German legislation allowing for deduction of expenses for non-residents only under specific circumstances is in breach of the freedom to provide services in Art. 49 EC Treaty.

Centro Equestre is a Portuguese corporation that toured with equestrian shows in 1996, e.g. in Germany. Withholding tax was levied on the proceeds. Such tax is refunded upon application to the extent it exceeds 50 % of the proceeds less expenses with a direct economic connection to the proceeds. Centro applied to have e.g. proportionate personnel costs, write-downs of horses and equipment for horsemen considered. This was rejected, as these expenses were not directly economically linked to the proceeds. The German Supreme Tax Court referred the case to the ECJ, asking if the freedom to provide services is infringed if a refund of tax to non-residents is only granted where the expenses with a direct economic connection to the proceeds exceed 50 % of these.

The A-G stated that it is in accordance with the territoriality principle that a State only considers income and expenses connected with the activity in that State for non-residents. To treat residents and non-residents differently in respect of necessary expenses connected to the activity is however discriminatory and infringes the freedom to provide services. The A-G referred to the ECJ judgment in the *Gerritse case (C-234/01)*, where expenses with *direct economic connection* to income in the State of the activity had to be considered equally for residents and non-residents. The A-G interpreted this as a requirement of causal economic connection, i.e. indirect expenses have also to be considered if they are causal to the income. He emphasised that expenses can only be deducted insofar as they are necessary to carry out the activity, i.e. if activity is carried out in several States, the expenses have to be deducted proportionally.

The A-G thus concluded that it is not discriminatory to require an economic connection between the taxable income and the expenses, for which a non-resident claims deduction. However, to require a *direct* economic connection only for expenses of non-residents is in breach of the freedom to provide services. Moreover, it is discriminatory that non-residents can only deduct expenses if these exceed 50 % of the proceeds, since there is no such limitation for residents. See EUDTG Newsalert NA 2006 – 15.

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Germany - Referral to ECJ on the non-deductibility of foreign currency losses in respect of foreign exempt permanent establishments: Deutsche Shell case (C-293/06)

A German resident company set up a permanent establishment (PE) in Italy in 1974. The allotted capital amounted to DEM 234,567,179. According to the double tax treaty between Germany and Italy, Italy had the right to tax the PE income. This income was tax exempt in Germany. The PE was disposed of in 1992 and the consideration was transferred back to the German head office. It consisted of profit from the sale and of the allotted capital. The foreign exchange rates applicable resulted in that the repaid allotted capital amounted only to DEM 111,868,677. The deduction of this currency loss was denied by the German tax authorities.

According to German case law, such foreign currency losses are part of the result of and caused by the existence of the foreign PE. If the PE income is exempt due to a tax treaty, such currency loss cannot be deducted in Germany. However, even though the loss would not be considered as part of the PE result in the sense of the treaty, it cannot not be deducted, as expenses connected with tax exempt income are not deductible according to law.

This resulted in that the loss was recognised neither in Italy (as the results there were accounted for in lira) nor in Germany.

On 8 June 2006, the Tax Court of Hamburg decided to refer the case to the ECJ, as it doubted whether this treatment is in accordance with the freedom of establishment. It pointed to the ECJ judgment in the *AMID case (C-141/99)*. Here a breach of the freedom of establishment was affirmed when a head office with foreign PEs could neither deduct losses in the State of the head office nor in the PE State, since this would have been possible, had the PEs been domestic ones. Accordingly, the non-deductibility of foreign currency losses in the present case is questionable, since such a loss would be deductible if the PE of the claimant had been in Germany. Even if a currency loss on allotted capital cannot occur in a domestic case, a domestic PE could e.g. enter into agreements in foreign currencies. Currency losses resulting from such agreements are tax deductible in Germany. These kind of foreign currency transactions are in the view of the Tax Court

economically comparable with the allotment of capital in foreign currency to a foreign PE. The non-deductibility of currency losses on capital allotted to foreign PEs thus constitutes a different treatment of comparable situations and is apt to deter the claimant from setting up PEs in other Member States.

In its referral to the ECJ, the Court also alluded to the ECJ judgments in the *Bosal Holding and Keller Holding cases (C-168/01 and C-471/04)* where it was decided that rules which make the deductibility of expenses dependent on these being connected to income and dividends taxable in the State of a parent company, are in breach of the freedom of establishment.

The present case concerns the relation between a head office and a foreign PE as opposed to a parent with a foreign subsidiary. However, the national rule denying deduction for expenses connected with tax exempt income applies here as well. In the view of the Court, this rule leads to the same type of excess taxation as for the parent companies in the *Bosal Holding and Keller Holding* judgments. Thus, the rule is not only apt to prevent a parent company from setting up foreign subsidiaries, but also to prevent a company in the situation of the claimant from setting up PEs in other Member States. In the view of the Court, this different treatment cannot be justified.
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Italy – ECJ judgement on the administrative charge: EC v Italy case (C-197/03)

In 1972, the administrative charge was introduced in Italy for registration in the register of commercial companies of the principal documents concerning the existence of companies (e.g. articles of association). Starting from 1985, the amount of the administrative charge increased and a new annual charge on companies was introduced. The aforementioned amendments had raised doubts on the compatibility of the mentioned charges with the EU Directive relevant to the taxation on the raising of capital (69/335/EEC). With reference to such a contrast between the domestic law and the Directive, proceedings were started before the ECJ

In 1993, in order to overcome the above-described incompatibility, it was decided to abolish the annual charge, to reduce the amount of the charge for registration of the articles of association and to introduce a charge for the registration of every subsequent document to the incorporation of the company. In the meantime, the ECJ ruled on the aforementioned preliminary questions submitted by the Italian Courts (C-71/91 and C-178/91) and confirmed the incompatibility with the Directive of an annual charge due for the registration of joint-stock companies.

Subsequently, Law n. 448/98 was introduced in order to regulate retroactively the reimbursement of the charges paid by companies in the period 1985-1992 (administrative charge and annual charge). Such a law established that, for the period 1985-1992, the maximum amount (fixed on the basis of the actual registration costs) that companies should have paid as the charge for registering the articles of association and for the annual charge (defined as a forfeit amount due for the registration of company documents subsequent to the registration of the articles of association), and established the refund of the higher amount actually paid. The same law fixed at 2.5% the interest rate on the amounts reimbursed (interest rate considerably lower with respect to the rates that would have been applied for the refund of other taxes). In addition, according to the Italian legislation, the request for a refund was to be filed within three years from the date of payment.

The reimbursement mechanism, was judged to be in contrast with the Directive. On 11 May 2006, the ECJ issued a decision (Case C-197/03) in which it established that the reimbursement

mechanism substantially introduced new charges for the registration of company documents that were added to the administrative charge already paid during the period 1985-1992. In fact, considering the temporal limitation to file the refund claims, companies cannot obtain the reimbursement of the administrative charge paid. Therefore, the new forfeitary amount due for the registration of company documents cannot be considered as fees for the registration service (the fees for the registration of company documents were already included in the administrative charge paid in the period 1985-1992). Moreover, the ECJ has established that, on the basis of its case law, the interest rate on the amounts refunded cannot be lower with respect to the rate that would have been applied for the refund of other taxes.

In conclusion, the ECJ stated that Italy, by establishing retroactive charges that do not constitute duties paid by way of fees and by applying less favourable conditions in the reimbursement of the higher charges, infringed EC Law.
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UK – A-G opinion on UK thin cap legislation: Test claimants in the Thin Cap group litigation v Commissioners of Inland Revenue case (C-524/04)

A-G Geelhoed delivered his opinion on 29 June 2006 partly in favour of the UK Government. The case relates to the UK thin capitalisation legislation as applied prior to 1 April 2004. The UK High Court had referred to the ECJ questions under Articles 43 (freedom of establishment), 49 (services) and 56 (free movement of capital) in relation to interest disallowances or addbacks suffered, or instances of increased equity having to be introduced or no or lower interest rates charged on certain debt, regarding financing of the UK subsidiaries of a French, a Swedish, and two US groups.

In essence, the questions referred sought (as regards the French and Swedish test claimants) to build on the ECJ's judgment in favour of the taxpayer in the *Lankhorst-Hohorst v FA Steinfurt case (C-324/00)*, and to ask the Court for their views in relation to situations where a third (i.e. non-EU) country company was involved (or a third country branch of an EU company).

First, the A-G opined that only Article 43 was engaged. Accordingly, in third country situations unless an EU (non-UK) lender also exercised a "definite influence" *(see: Baars case: (C-251/98))* over the UK borrower, no EC Treaty freedom would be engaged.

Secondly, the UK thin cap provisions before 1 April 2004 (when they were extended to UK to UK controlled situations) gave rise to disadvantageous UK tax treatment only in the cross border situation, which the A-G considered discriminatory rather than arising from allocation of taxing rights as the UK had argued.

Nonetheless, these provisions were capable of justification provided they were proportionate. In this regard, it must be possible for a subsidiary to demonstrate without undue burden that the financing actually adopted was in fact carried out for genuine commercial reasons other than to gain a tax advantage, and also the UK must ensure the reciprocal recognition by the State of residence of the parent company of any UK re-qualification of interest paid by the UK subsidiary as a distribution or other disallowance. See EUDTG Newsalert NA 2006 – 16.
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Back to top

NATIONAL DEVELOPMENTS

Germany - Federal Tax Court judgement on transitional rules applying only to foreign shares in 2001 (VIII B 107/04)

In its judgement dated 14 February 2006, the Federal Tax Court expressed serious doubts whether the application of German rules for the taxation of capital gains from the alienation of shares as amended by the Tax Reduction Act 2001/2002 is compatible with the free movement of capital (Art. 56 EC) for the year 2001.

In the decided case, a taxpayer acquired 2 % of the capital of an Italian non-listed corporation (I-SpA) in March 2000. After I-SpA went public, the taxpayer sold his shares in 2001. The German tax office took the position that the capital gains arising from the sale would have to be taxed under the amended German rules for the taxation of capital gains from the alienation of shares (which foresee a minimum participation of 1 %). If instead the former provisions were applied no capital gains taxation would have occurred (because they foresaw a minimum participation of 10 %). However, for the year 2001 only capital gains from the sale of foreign shares were subject to the amended provisions (i.e. a taxpayer selling shares in a domestic corporation would still have benefited from the former 10 % participation requirement).

In its decision the Federal Tax Court acknowledged that the German tax rules in question infringe the free movement of capital. One of the arguments was that based on the jurisprudence of the ECJ also an unfavourable treatment with minor effects is sufficient in order to hinder a taxpayer from exercising the fundament freedoms.

In addition, the Federal Tax Court was of the opinion that the discrimination can neither be justified by "coherence" nor can be considered as being proportionate.

Even though the Federal Tax Court had serious doubts whether the German provisions in question are in line with the free movement of capital it did not refer the case to the ECJ because the case concerned only the question whether a tax assessment might be executed (i.e. the final judgement about the interpretation of the law is still outstanding). Therefore, it postponed till the final assessment whether a breach of the fundamental freedoms is given to the decision on the merits of the case.
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Netherlands – A-G opinion on dividend withholding tax on outbound dividends

On 10 May 2006, the A-G to the Dutch Supreme Court opined that the free movement of capital (Art. 56 EC) is violated if outbound dividends are subject to dividend withholding tax, whereas – in comparable circumstances – inbound dividends are exempt from that tax.

The case is as follows. The Luxembourg X Sarl owns 2.25% of the shares in the Dutch A NV. The dividends A NV distributed to X Sarl in 2001 and 2003 were subject to 25% Dutch dividend withholding tax (actually 15% under the Netherlands – Luxembourg tax treaty). X Sarl applied for exemption from dividend withholding tax relying upon the free movement of capital (Art. 56 EC).

The Dutch Dividend Withholding Tax Act provides for two exemptions in shareholder / investee company relations. The first exemption (cross-border exemption) applies to cross-border dividends

covered by the EU Parent-Subsidiary Directive provided that the parent company owns a shareholding 25% (years 2001 and 2003). The second exemption (Internal exemption) applies to dividends distributed to a Dutch parent company whose shareholding, for Dutch corporate income tax purposes, qualifies for the Dutch participation exemption. From the facts it can be derived that none of the exemptions was available for X Sarl. It should be noted that the internal exemption would have applied if X Sarl would have been a tax resident of the Netherlands.

On 13 October 2005, a Dutch Lower Court judged the internal exemption is contrary to Art. 56 EC as it effectively differentiates between resident and non-resident shareholders to the detriment of non-resident shareholders. See Newsletter 2005 – nr. 003. The State Secretary of Finance appealed against the Lower Court's judgement.

The A-G is of the opinion that from a Dutch perspective as well as an overall perspective, X Sarl is completely comparable with a Dutch company which owns the shares in A NV. From a Dutch perspective, it is without doubt that the exemption would have applied if X Sarl had been tax resident of the Netherlands. From an overall perspective X Sarl is in the same position as a Dutch corporate shareholder because, in Luxembourg, the participation applies to the shares in A NV held by X Sarl. In both situations the dividends are exempt from corporate income tax.

Consequently, the A-G concludes that the internal exemption infringes the free movement of capital. Moreover, the infringement is an "acte clair". Therefore, there is no need to stay the procedure until the ECJ has made its judgement in the *Denkavit case (170/05)* or any other ECJ judgement on the obligations under EC Law of a source state in situations where a tax treaty is in place.
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Netherlands – Substantial revision of the Corporate Income Tax Act

On 24 May, 2006, a Bill was published to revise the Corporate Income Tax Act substantially. The revision has as one of its main purposes to bring the Corporate Income Tax Act in line with EC Law. The Dutch EUDTG is of the opinion that, although the Bill improves the EU compatibility of the Corporate Income Tax Act, there are still many opportunities unused. Let's give a short summary of the main amendments.

- The corporate income tax rate will be reduced to 25.5%. The dividend withholding tax rate will be reduced to 15%.

- A royalty box at an effective rate of 10% and an intra-group interest box at an effective rate of 5% will be introduced. The entering into force of the provisions on the boxes will be conditional upon the approval by the EC.

- The application of the participation exemption to foreign shareholdings will no longer depend on the fulfilment of the non-portfolio investment test and the subject to tax test. Instead, the participation exemption will apply to *domestic* and *foreign* participations, unless the participation qualifies as a low taxed portfolio investment (including intra-group financing). In that situation economic double taxation will be relieved by a lump sum credit of 5% for the underlying corporate income tax. For EU participations a credit for the actual underlying corporate income tax can be claimed. A participation is regarded to be low taxed if the taxation is lower than 10% on a tax basis which is in accordance with Dutch standards.

- The temporary restriction of deduction of interest on intra-group loans used for the acquisition of subsidiaries which are joined in the fiscal unity with the acquiring parent company will be abolished. Instead, the interest on intra-group loans used for third party acquisitions will not be deductible, unless evidence to the contrary can be given. That provision currently already applies to intra-group acquisitions. The evidence to the contrary will inter alia be given if, in the hands of the recipient, the interest is taxed at a rate of at least 10% on a tax basis which is in accordance with Dutch standards.

- In 2005, the Dutch State secretary of Finance announced the extension of the fiscal unity rules (group consolidation) to non-resident group companies. However, after the ECJ judgement in the *Marks & Spencer case* (C-446/03), that plan was withdrawn. Instead, the current provision on the deductibility of losses incurred upon liquidation of tax exempt participations will be continued. The differentiation between resident and non-resident participations in that provision will be abolished.

- Depreciation of real estate will be limited.

The Bill still has to be approved by the Second and First Chambers of the Parliament. The Revised Corporate Income Tax Act is expected to become effective as from 1 January 2007.
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UK – New legislation to allow relief for certain EEA losses

Following the ECJ's judgment in the case of *Marks & Spencer plc v Halsey* (C-446/03), the UK group relief legislation is to be amended to allow relief for certain EEA losses. Draft legislation has been included in the Finance (No.2) Bill 2006, which is expected to be enacted in July 2006.

For accounting periods commencing on or after or straddling 1 April 2006 group relief may be available in the UK for losses of a company resident in the EEA, or a company resident in a territory outside the EEA but which carries on a trade through a permanent establishment (PE) in an EEA territory. The non-UK resident surrendering company must either be a 75% subsidiary of a UK resident claimant company, or both the surrendering company and the claimant company must be 75% subsidiaries of a UK resident company.

However, an amount will not be available for surrender as group relief unless it meets certain conditions. In particular, the loss will only be available for UK group relief if there is no possibility of the loss being relieved in current, past or future periods in the relevant EEA territory (or any other territory of residence of the surrendering company), and the loss has not already been relieved in any other territory.

Even if the conditions are met, relief will not be available if the loss arises or qualifies for group relief due to arrangements being entered into with a main purpose of obtaining UK group relief for the loss. This 'unallowable loss' rule applies mainly for arrangements made on or after 20 February 2006.
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UK - Consultation on UK taxation of foreign profits

A number of cases concerning the UK taxation of foreign profits have recently been referred to the ECJ, including the case of Cadbury Schweppes plc and Cadbury Schweppes Overseas Limited v CIR (C-196/04) concerning the UK controlled foreign companies legislation, and the case of Test Claimants in the FII group litigation v Commissioners of Inland Revenue (C-446/04) concerning the UK taxation of foreign dividends.

In the light of these cases the UK Treasury and HM Revenue & Customs are now actively considering changes to the current UK system of taxation of foreign profits, and are running a series of consultation meetings with professional bodies and business representatives. Proposals under discussion include the possibility of an exemption system for foreign dividends (and an associated restriction on the deductibility of interest and other expenses attributable to investments in foreign shareholdings), and possible reform of the controlled foreign company regime.
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Back to top

EU DEVELOPMENTS

Italy – Italy referred to ECJ by the European Commission over its "golden share" rules: AEM S.p.A. case (C-463/04 and C-464/04)

On 26 May 2006, the European Commission referred Italy to the ECJ for its "golden share" rules. The Commission considers that certain Italian civil law provisions on investment in privatised companies constitute unjustified restrictions on the free movement of capital and the right of establishment (Articles 56 and 43).

This is not the only case pending before the ECJ on Italy's "golden share" rules (AEM S.p.A. case: joined cases C-463/04 and C-464/04). AEM S.p.A. is an Italian joint-stock company operating in the field of distribution of gas and electricity. In 2004, the Municipality of Milan decided to transfer part of its shares in the company to private investors. The Italian Civil Code (art. 2449) provides that public entities like the Municipality of Milan, which hold a shareholding in a joint-stock company, can appoint one or more Directors of the company, if the Company By-laws so provide. Italian Law Decree n. 332/94, regarding the privatisation of joint-stock companies with shares held by the State and by public entities, permits that the Company By-laws guarantee special powers to the public entities (art. 2) and provide for particular mechanisms for the appointment of the Directors in view off protecting the minority shareholders (art. 4, so called "*voto di lista*"). The special powers granted to public entities were amended in 2003 on the basis of a judgement of the ECJ (C-58/99), according to which the same powers were deemed to be in breach of art. 56 EC (in particular, based on the amended art. 2, the public entities can directly appoint only one Director without a right to vote, while on the basis of the previous law, the same could directly appoint up to ¼ of the Board of Directors).

The Municipality of Milan, prior to executing the transfer of the shares, which involved the switching from an absolute majority (51%) to a relative majority (33.4%), amended the Company By-laws of the company with reference to the appointment of Directors. In particular, the Municipality of Milan

reserved itself the right to directly appoint two Directors (based on art. 2449 of the Italian Civil Code) and provided for the "*voto di lista*" mechanism for the appointment of the remaining part of the Board of Directors. The jointed application of direct appointment and "*voto di lista*" allows the Municipality of Milan to appoint, in any case, the majority of the company's Directors even though it does not own the absolute majority of the share capital of AEM S.p.A. "*Federconsumatori*" (association for the defence of consumer rights) and "*Associazione dell'azionariato diffuso dell'AEM*" (association of the minority shareholders of AEM S.p.A.) appealed against the amendment of the Company By-laws arguing that it was in contrast with the free movement of capital (Art. 56 EC). In fact, according to the plaintiffs, the mechanism of appointment of the Directors adopted would limit the interest in the company, discouraging anybody wishing to acquire shares in AEM S.p.A. with the scope of managing the same.

The Administrative Regional Court of Lombardy referred to the ECJ requesting it to establish whether the following is in compliance with the free movement of capital:

- the appointment of two Directors pursuant to art. 2449 of the Italian Civil Code;

- the joint application of the direct appointment (art. 2449 of the Civil Code) and the "*voto di lista*" (art. 4 of the Law Decree n. 332/94), which guarantees, in any case, the appointment of the majority of the Directors by the Municipality of Milan;

- the application of art. 2449 of the Italian Civil Code, where the same is in contrast with a domestic law (art. 2 of the Law Decree n. 332/94) and does this result in compliance with the provisions of art. 56 of the EC Treaty.

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EU - Council adopts code of conduct on transfer pricing documentation for associated enterprises

On 20 June 2006, the EU's Council of Ministers adopted a Resolution on the European Commission's proposal for a code of conduct on transfer pricing documentation for associated enterprises. The proposal is based on the work done by the EU Joint Transfer Pricing Forum. The EU Member States must now implement this code in their legislation and administrative practices.

The code of conduct will standardise the documentation required from multinational companies by the tax authorities on the pricing of their cross-border intra-group transactions in the EU. It should also significantly reduce the tax complications for companies that trade with associated enterprises across borders. The documentation will be optional for companies and cover all group entities resident in the EU, including transactions between group entities resident in the EU and associated enterprises outside the EU. The documentation consists of a so-called "master file", a "blue print" of the company and its transfer pricing system that would be relevant and available to all EU Member States concerned, and "country-specific documentation" for each of the specific Member States concerned with the intra-group transactions, which would only be available to the relevant Member State. The code of conduct is expected to reduce the risk for companies of double taxation and exposure to documentation-related penalties. Click here for the full text of the code of conduct.

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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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