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## ECJ CASES

**Germany – A-G Opinion on joint filing for spouses resident in different Member States: Finanzamt Dinslaken vs. Gerold Meindl case (C-329/05)**

In June 2005, the German Supreme Tax Court referred a case concerning the requirement for joint filing for spouses to the ECJ (see EU Tax News Issue 2005 - nr. 003): Mr. Meindl, an Austrian citizen resident in Germany, had German income of DEM 132,422 in 1997. His Austrian resident spouse drew tax exempt maternity allowance of DEM 26,995 in Austria. They applied for joint filing in Germany to benefit from the split tax rate. This was rejected, since joint filing where one spouse is non-resident requires that - calculated according to German law - at least 90 % of the aggregate income is subject to German tax, or the income not subject to German tax does not exceed DEM 24,000. Neither of these requirements was fulfilled, as German tax law only exempts German maternity allowances from taxation.

In his Opinion of 13 July 2006, A-G Léger stated that Mr. Meindl is protected by the freedom of establishment, since he is an Austrian citizen who carried out activities as self-employed in Germany. Even though he was resident and derived his whole income in Germany, he was treated differently from German resident taxpayers, whose unemployed spouses are resident in Germany, since these taxpayers are granted joint filing.

In the A-G's view, an Austrian citizen who works and lives in Germany and whose unemployed spouse lives in Austria is in an objectively comparable situation with a German resident taxpayer, whose unemployed spouse resides in Germany. In both cases, the aggregate income originates from the occupation of one spouse. The requirement of German residency for the unemployed spouse, which is the basis for the different treatment, is more likely to be fulfilled by German nationals.

Mrs. Meindl did indeed derive benefits in Austria, which were taxable according to German tax law but tax exempt in Austria. However, the A-G concluded, in accordance with the ECJ judgment in *Wallentin (C-169/03)* that tax exempt items do not constitute relevant income, since due to the exemption that State cannot account for the family and personal circumstances of the taxpayer. This can be applied to the case at hand: firstly, the benefit that Mrs. Meindl drew in Austria would have been tax exempt, had it been paid according to German law and it would have consequently been ignored when calculating the aggregate income. Secondly, the effect of the German rule is that personal and family circumstances are not considered anywhere: since there was no taxable income in Austria, Austria can also not account for the personal and family situation of Mr. Meindl.

According to ECJ case law, discrimination occurs where personal and family circumstances can be taken into account neither in the State of residence nor in the State of employment. In the present case, Germany as the State where the major part of the income is derived is best suited to consider the personal and family situation of Mr. Meindl.

The A-G thus suggests that the ECJ should hold that the freedom of establishment precludes a national rule, according to which a German resident taxpayer is denied joint filing merely due to the fact that his Austrian resident spouse derives more than 10 % of the aggregate family income and this exceeds DEM 24,000, where this income is tax exempt according to Austrian law.
-- Caroline Naumburg and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

**Hungary – Referral to ECJ regarding freedom of establishment: Cartesio case (C-210/06)**

On 5 May 2006, a Hungarian Court of Appeal referred preliminary questions to the ECJ with respect to the interpretation of, inter alia, the scope of the freedom of establishment in connection with a rejected request from a Hungarian legal entity to transfer its registered office from Hungary to Italy while remaining registered as a legal entity in the Hungarian Court of Registration.

Cartesio, a Hungarian resident legal entity, requested the Court of Registration to register the transfer of its registered office from Hungary to Italy. The Court of Registration rejected the request and informed Cartesio that Hungarian law does not allow a registered office to be transferred abroad while remaining registered in Hungary. Cartesio appealed against this decision as, in its opinion, on the basis of both international civil law and the freedom of establishment in Community Law, it should be possible for Cartesio to transfer its registered office to another EU Member State while remaining registered in Hungary.

Under Hungarian law, transferring a registered office to another EU state would mean that the legal entity would first have to go into voluntary liquidation. The relevance of the ECJ decision, if affirmative, is whether Cartesio, on transferring its registered office to another EU Member State, would have to form a branch in Hungary or would become a non-resident Hungarian legal entity.

The Court of Appeal suspended the proceedings and referred a number of preliminary questions concerning Cartesio’s appeal against the order of the Court of Registration to the ECJ.
-- Gabriella Erdos, Hungary; gabriella.erdos@hu.pwc.com

**UK – Referral to ECJ concerning compatibility of UK CFC rules with EC Treaty: Vodafone 2 v HRMC case (SpC 479)**

The UK Revenue authority (HMRC) opened an enquiry into Vodafone 2's tax return for its accounting period ended 31 March 2001 and raised a number of questions relating to the controlled foreign company (CFC) status of one of Vodafone 2's subsidiaries. Vodafone 2 made an application for the enquiry to be closed, arguing that the UK's CFC legislation is contrary to the EC Treaty. HMRC refused closure and the taxpayer appealed to the Special Commissioners.

In 2005 the Special Commissioners referred the case to the ECJ for a preliminary ruling on the compatibility of the UK's CFC regime with the EC Treaty. HMRC appealed the referral decision but in November 2005 the UK High Court upheld it. On 28 July 2006 the UK Court of Appeal dismissed HMRC's appeal, so the referral to the ECJ stands.

This is now the third case concerning the UK CFC rules to be referred to the ECJ and primarily concerns wjether a Member State can pursue an enquiry into a situation where the legislation in question is considered to be potentially contrary to the EC Treaty. The other cases are the *Cadbury case (C-196/04)* and the *CFC and dividend Group Litigation (C-201/05)*, both of which have already been referred to the ECJ.
-- Chloe Paterson and Peter Cussons, United Kingdom; peter.cussons@uk.pwc.com

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## NATIONAL DEVELOPMENTS

**Austria – Capital Duty on intra-Community movement of effective centre of management: Auer case: (C-251/06)**

The Austrian Independent Fiscal Court referred a request for a preliminary ruling to the ECJ on whether Austria is allowed to levy capital duty on a corporation which moved its place of effective management from Germany to Austria.

Germany abolished capital duty in 1992, whereas Austria still levies a capital duty of 1% on contributions of equity to corporations. Capital duty is also due when a foreign corporation transfers its place of effective management to Austria. In the case at hand, an Austrian company transferred its effective centre of management from Germany to Austria in the year 1999 in order to avoid capital duty on an equity contribution of approximately EUR 7 m. The Austrian tax office assessed capital duty of 1% of the net fair market value of the company. The company filed an appeal against this assessment arguing that Art. 7 of Directive 69/335/EEC prohibits Austria from charging capital duty to a company transferring its effective centre of management from Germany to Austria, even where Germany - prior to the formation of the company - had waived the charging of capital duty by repealing the relevant national legal basis for that duty.

This preliminary ruling is a chance for the ECJ to further clarify principles of the taxation under Directive 69/335/EEC in the pan-European context. We expect that the preliminary ruling will be of importance for structuring and planning transactions involving Member States which charge capital duty und others which do not. From an Austrian perspective, this will not be only of relevance in relation to Germany, but also to other Member States that abolished capital duty.
-- Friedrich Roedler, Austria: friedrich.roedler@at.pwc.com

**Finland – Accession of the new Member States to the Arbitration Convention implemented**

Finland has ratified the Accession Convention, which extends the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, also known as the Arbitration Convention (90/436/EEC) to the 10 new EU Member States. The Accession Convention entered into force in accordance with its Art. 5 on 1 September 2006 between Finland and those Member States that have also ratified the Accession Convention.

The Arbitration Convention aims to abolish double taxation caused by adjustment of taxable income in cases of cross-border transactions between associated companies. Should Member States be unable to eliminate the double taxation due to a failure of corresponding adjustments, then the Arbitration Convention prescribes the procedure to be followed to abolish the double taxation.
-- Lari Hintsanen and Jarno Laaksonen, Finland; lari.hintsanen@fi.pwc.com

**Germany – Commission decides to refer Germany to the ECJ in respect of tax legislation concerning pension savings grant: "Riester-Rente”**

On 4 July, 2006, the Commission announced that it will refer Germany to the ECJ due to discriminatory provisions in the tax legislation concerning pension savings grants. The Commission had sent a formal request to Germany to change the legislation in 2005 to which Germany never reacted.

In the Commission's view, three elements of the legislation are not in line with Community Law.

Firstly, in order to qualify for the grant, the person applying has to be subject to worldwide taxation in Germany (i.e. either be domiciled or have their customary place of abode in Germany). This requirement discriminates against non-residents.

Secondly, the savings (including the grant) can up to a certain amount be used for acquisition of a dwelling in Germany without impact on the tax deductibility. This does not apply to acquisitions of dwellings outside Germany, e.g. cross-border commuters cannot use their savings to buy a dwelling in their Home State and still get the tax deduction.

Thirdly, the grant must be repaid in case the individual ceases to be subject to full taxation in Germany, i.e. if migrant workers return to their Home State or if individuals migrate upon retirement. The requirement of repayment in case of migration shows similarities to the French and Dutch exit tax cases *Hughes de Lasteyrie du Saillant* (*C-9/04)* and "*N" (C-470/04*; see EUDTG Newsalert NA 2006 – 21) which were decided in favour of the taxpayers. Furthermore, it is also similar to the German exit tax provision in Section 6 of the International Transactions Tax Act, which stipulates a deemed sale of qualifying participations (more than 1 %)  in certain cases upon migration. This section was challenged by the Commission in 2005 and the German Ministry of Finance has by way of Decree regulated an interest-free deferral of this exit tax upon intra EU/EEA migrations until a disposal actually takes place.
-- Caroline Naumburg and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

**Netherlands – A-G opinion on deduction of cross-border losses from own property (case 39/258)**

In 1996 and 1997, X lived in Belgium on his own property, but worked as a civil servant in the Netherlands and was therefore subject to unlimited tax liability in the Netherlands (deemed residency). However, according to the Netherlands-Belgium tax treaty, X was resident of Belgium and therefore the Netherlands was only entitled to levy tax on sources of income insofar as they were allocated to the Netherlands (in this case the income from civil service). In the Netherlands residents are taxed on personal use of own property and, consequently, they may deduct the expenses related thereto. X claimed deduction of the losses incurred by his Belgian own property in the Netherlands and argued that the differential treatment of residents and non-residents was in breach of Community Law. Finally, he took the case to the Dutch Supreme Court, which stayed the proceeding in anticipation of the ECJ judgement in the *Ritter-Coulais case (C-152/03).* (see EUDTG Newsalert NA 2006 – 03)

On 19 April 2006, the A-G to the Dutch Supreme Court delivered an additional conclusion. At an earlier stage, the A-G had been of the opinion that ECJ case law - as it stood at that time - did not require Member States to consider foreign losses when determining the tax base for non-residents. In his additional opinion, the A-G first establishes that the Ritter-Coulais judgement does not provide the answer to the question whether foreign losses must be deducted from the tax base of non-residents.

Then the A-G considers recent ECJ judgements, in particular the *Marks & Spencer case (C-446/03*; see also EUDTG Newsalert NA 2006 – 16) and the *Schempp case (C-403/03;* see also EUDTG Newsalert NA 2006 – 04). As in the absence of positive taxable income in Belgium X could not deduct the losses incurred by his own property, a comparison can be made to the Marks & Spencer case. In that case the ECJ ruled that Community Law enforces cross-border losses to be carried over if the possibilities for offsetting by the company which incurred these losses are exhausted. According to the A-G, such a rule (he refers to it as the “anyhow somewhere principle”) only applies if the Member States involved treat the relevant income in a similar way. It follows from the Schempp case that the fundamental freedoms as laid down in the EC Treaty do not remove differences in the national tax laws of the Member States (disparities), although they may affect

cross-border situations in a negative way. As in Belgium losses from one's own property can only be off-set against positive income from own property, Belgium should not have allowed what X claimed in the Netherlands: i.e. deduction of own property losses from employment income. For that reason, the A-G regards the differences between the Dutch and Belgian tax laws as a disparity, to which the EC Treaty does not apply.

In case the Supreme Court should not follow the "disparity" approach, the A-G suggests three alternatives:

- Application of the "anyhow somewhere principle", in which case an investigation is needed to establish whether X's possibilities to off-set the losses in Belgium are exhausted;
- Observing the Belgium-Netherlands tax treaty; or
- Granting of national treatment to X.

The A-G prefers the second alternative as neither the relevant treaty provisions nor the national treatment of X as a deemed resident are in conflict with Community Law. It may be clear that the A-G rejects the last alternative.
-- Irma van Scheijndel, Netherlands; irma.van.scheijndel@nl.pwc.com

**Netherlands – A-G opinion on abuse of Community Law (cases 42626-629, 31 and 32)**

On 6 June 2006, the A-G to the Dutch Supreme Court opined on a base erosion structure. The simplified structure is as follows: A BV remained a dividend distribution to B BV indebted. At the same time, B BV transferred its seat to Aruba and contributed its receivable on A BV as capital to a newly incorporated Aruba Co. A BV deducted the interest due on the debt to the Aruba Co at a rate of 35% and the Aruba Co was taxed at the corresponding interest income at a rate of 3%. The tax inspector denied the deduction of interest in A BV's tax assessments over the years 1992 up to and including 1997 and based his decision on the general anti-abuse doctrine *(fraus legis)*, except for the assessment in respect of 1997 which he based on the relevant Corporate Income Tax provision. A BV unsuccessfully appealed against the tax inspector's decision and, subsequently, took the case to the Dutch Supreme Court. Amongst arguments, A BV took the position that the denial of interest is in breach of the free movement of capital.

In the past, the Supreme Court has applied the general anti-abuse doctrine to artificial equity into debt conversion structures, as a result of which deduction of the interest due on the thus created intra-group debt was denied. As from 1997, that case law has been codified in the Corporate Income Tax Act as follows.

The A-G first refers to the judgement made by the Supreme Court on 23 January 2004 (BNB 2004/142). In that case – which is similar to the present case - the Supreme Court had reasoned that it could not reasonably be doubted that the taxpayer had no access to the EC Treaty, since the court had established abuse of national law in the 'individual' case. The Court based its reasoning on settled case law by the ECJ. According to the A-G, the later ECJ judgements in the *Halifax case (C-255/02)* and *Huddersfield case (C-419/02)* make such reasoning questionable. In those cases, abuse of national law had been established by the national courts. In both cases the ECJ ruled that the litigant had access to the EC Treaty. The ECJ ruled nevertheless, that the rights under Community Law are forfeited if abuse of Community Law can be found. In the Halifax case and Huddersfield case, the ECJ elaborated guidelines for national courts in order to determine whether abuse of Community Law applies to individual cases.

In the present case, the A-G is of the opinion that access to the EC Treaty cannot be denied. In addition, he considers that the conditions for finding abuses of Community Law do not principally deviate from those for applying the national anti-abuse doctrine. However, it also follows from the Halifax case and the Huddersfield case that anti-abuse provisions must meet the proportionality

test. According to the A-G, it is not an "acte clair" whether the present anti-abuse doctrine / provision is proportionate because it denies deduction of the full interest, whereas the corresponding interest income is taxed, albeit not according to Dutch standards. In that case the aim of the doctrine / provision is ensured, however, the measure goes beyond what is necessary for that purpose. Therefore, the case should be referred to the ECJ for a preliminary ruling, the more so because a capital movement between a Member state and a third state are involved.
-- Irma van Scheijndel, Netherlands; irma.van.scheijndel@nl.pwc.com

**Netherlands – Lower Court judgement on cross-border loss relief (case 05/4260)**

On 7 July 2006, a Dutch Court of First Instance rejected a request for a cross-border loss relief.

X BV, incorporated under Dutch law and tax resident of the Netherlands, owns 100% of the shares of Y NV, incorporated under Belgian law and tax resident of Belgium. Y NV has no permanent establishment in the Netherlands. For Dutch corporate income tax purposes, a fiscal unity is allowed for resident companies and non-resident companies to the extent the latter carry on an enterprise through a permanent establishment in the Netherlands. The taxi nspector dismissed the request filed by X BV and Y NV for obtaining the fiscal unity facility. X BV appealed against the tax inspector's decision and argued that precluding non-resident subsidiaries from the fiscal unity facility is breaching the freedom of establishment (Art. 43 EC) and the free movement of capital (Art. 56 EC).

The Court first established that precluding non-resident group companies from consolidating profits and losses hinders the exercise by a resident parent company of its freedom of establishment by deterring it from setting up subsidiaries in other Member States. The present restriction, however, follows from the allocation of taxing rights between the Netherlands and Belgium, which differentiates between residents and non-residents. The freedom of establishment does not apply to such restrictions. The Court then held that the ECJ does not accept unconditionally that residents and non-residents are not comparable for tax purposes. However, in the *Marks & Spencer case (C-446/03*; see also EUDTG Newsalert NA 2006 – 16), the ECJ has justified the UK group relief rules, which only apply to resident group companies.

Although the rules of reason accepted by the ECJ in the Marks & Spencer case are not to be invoked equally in respect of the Dutch fiscal unity system, the Court judged that the outcome of the Marks & Spencer case also applies to the present case: the disallowance of cross-border loss relief is not in breach of the freedom of establishment. Regrettably, the Court did not refer the case to the ECJ for a preliminary ruling.
-- Irma van Scheijndel, Netherlands; irma.van.scheijndel@nl.pwc.com

**Netherlands – Abolition of discriminatory taxation on outbound dividends following complaints by PwC and EFRP**

In July 2006, in reply to the European Commission's formal request to the Netherlands to abolish the discriminatory tax treatment of outbound dividends following a complaint lodged with the Commission against the Netherlands by PricewaterhouseCoopers' EU Direct Tax Group and the European Federation for Retirement Provision (see EUDTG Newsalert NA 2006 – 16), the Dutch Ministry of Finance issued a supplement to the proposed legislation pending before parliament.

The supplement should reduce the Dutch dividend tax burden for foreign investors further. Firstly, EU pension funds which are tax exempt in their Member State will be granted the right to claim a refund of Dutch dividend withholding tax on dividends distributed to these funds by companies resident in the Netherlands. Second, no Dutch dividend tax will have to be withheld in case of a distribution to an EU resident company which holds 5% or more of the shares in the Dutch

distributing company. The proposed refund procedure is expected to become effective as from 2007 and can be regarded as a next step towards the non-discrimination of EU pension funds and companies receiving dividends from the Netherlands.
-- Irma van Scheijndel and Sjoerd Douma, Netherlands; sjoerd.douma@nl.pwc.com

**UK – Implementation of the Hoechst decision: Deutsche Morgan Grenfell case**

Prior to the abolition of advance corporation tax (ACT) in 1999, where a UK company entered into a group income election with its parent company, it was not required to pay ACT in respect of dividend payments made to the parent company. However, only UK resident companies were permitted to make a group income election. Consequently a UK resident subsidiary of a UK resident parent company could pay a dividend to its parent without paying ACT, but a UK resident subsidiary of an EU parent company was required to pay ACT in respect of dividends paid to its parent company.

On 8 March 2001, the ECJ ruled in the joined *Hoechst* and *Metallgesellschaft* cases *(C-410/98 and C-397/98)* that the UK group income election rules relating to dividends were in breach of the EC Treaty. Further claims were linked in a consolidated action (a Group Litigation Order or "GLO"). The GLO was divided into 3 classes based on specific characteristics of the claims and Class 1 related to claims mainly by French and German parented companies where the parent was not entitled to a tax credit under the relevant double taxation treaty. The UK Revenue authority (HMRC) has negotiated settlements for Class 1 claimants subject to agreement of the periods to which claims can be referred back.

Deutsche Morgan Grenfell is the test case for Class 1 claims. On 4 February 2005, the UK Court of Appeal held that claims for repayment of ACT must have been made within 6 years of payment of the ACT. This overturned an earlier High Court decision which had indicated that claims for repayment must have been made within 6 years of the date of the ECJ decision in *Hoechst* (and which would have potentially enabled taxpayers to reclaim all ACT paid in respect of EU dividends since the introduction of ACT in 1972). The taxpayer appealed the Court of Appeal judgment, and the appeal was heard by the House of Lords (the UK Supreme Court) in July 2006. The House of Lords decision is now awaited.
-- Chloe Paterson and Peter Cussons, United Kingdom; peter.cussons@uk.pwc.com

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## EU DEVELOPMENTS

**EU – Commission formally requests Belgium, Spain, Italy, Luxembourg, Netherlands and Portugal to change the taxation of outbound dividends**

The European Commission announced on 25 July 2006 that formal requests had been sent to Belgium, Italy, Luxemburg, Netherlands, Portugal and Spain regarding the taxation of outbound dividends to companies that are a resident of the EU or the EEA.

In all these Member States, non-resident shareholders / companies are taxed higher than resident shareholders / companies. Where a dividend is distributed by a company to a resident shareholder / company the dividend in the hands of the shareholder is not taxed at all or is taxed at a very low rate. A dividend distribution to a non-resident shareholder / company is subject to (withholding) tax in the range of 5% to 25%. The Commission takes the view that this differential treatment is an infringement of the freedom of establishment and the free movement of capital, as provided for in the EC Treaty.

These formal requests are another clear signal that the taxation of outbound dividends is not in line with the EC Treaty, if it distinguishes between domestic and foreign shareholders. This view is supported by the findings of the European Free Trade Association (EFTA) Court in the *Fokus Bank judgement* (E-1/04) and the conclusion of A-G Geelhoed in the *Denkavit case (C-170/05)*. Although the case law of the ECJ is not clear in every single respect, the tendency is very clear.

The Commission's requests support the 26 complaints lodged with the Commission against 18 Member States by PricewaterhouseCoopers' EU Direct Tax Group and the European Federation for Retirement Provision (EFRP) on the discriminatory treatment of EU pension funds on their cross-border portfolio investments (see EUDTG Newsalert NA 2006 – 15). Pension funds –but also investment funds such as SICAV's and OEIC's- that are liable to dividend withholding tax when they are making cross-border investments in Belgium, Italy, Luxembourg, the Netherlands, Portugal and Spain are well advised to consider their position in these countries. Although, these formal requests may not in every case target the specific taxation of outbound dividends to pension funds and investment funds, it is definitely a new landmark showing that the taxation of outbound dividends must be in line with the EC Treaty.

The request is in the form of a Reasoned Opinion under Art. 226 EC. If the Netherlands does not reply satisfactorily to the Commission within two months, the latter may refer the matter to the ECJ.
-- Cees Peters, Netherlands; cees.peters@nl.pwc.com

**Belgium – Commission requests Belgium to end discrimination in Flemish registration tax**

On 20 July 2006, the European Commission sent Belgium a formal request to end discrimination in the Flemish registration tax. According to the Flemish Region's registration duty legislation, when residents purchase a new house in the Flemish Region, it is possible to deduct from the registration tax on this purchase, the amount of registration tax paid earlier on another house provided the house was located in the Flemish Region. However, citizens moving from another Member State to the Flemish Region purchasing a house within this Region cannot get a credit for the registration tax paid earlier on the purchase of a house in their Member State of origin.

The Commission considers that the Flemish Region's legislation is a restriction of the right of every EU citizen to move and reside freely within the territory of the EU (Art. 18 EC), the freedom of establishment (Art. 43 EC) and the free movement of capital (Art. 56 EC).

The request is in the form of a Reasoned Opinion under Art. 226 EC. If Belgium does not reply satisfactorily to the Commission within two months, the latter may refer the matter to the ECJ.
-- Caroline Goemaere and Laurens Narraina, Belgium; laurens.narraina@pwc.be

**Belgium – Commission requests Belgium to end discriminatory taxation of inbound dividends**

On 20 July 2006, the European Commission sent Belgium a formal request to end the discriminatory taxation of dividends paid by foreign companies (inbound dividends) to Belgian private investors. Under Belgian tax legislation, there is no double taxation for domestic dividends while there is for inbound dividends. Indeed, Belgian private investors receiving domestic dividends either pay a final tax withheld by the company or they are taxed at a special income tax rate of, in principle, 25%.

Inbound dividends are firstly subject to a withholding tax in the source State, subject to a reduction based on the double tax treaty concluded between Belgium and the source State, and then suffer

Belgian income tax at the special income tax rate of 25%. The result is that inbound dividends are taxed more heavily than domestic dividends.

The Commission stated in a Communication dated 19 December 2003 that the higher tax burden on inbound dividends constitutes a restriction in the sense of Art. 56 EC on individual taxpayers to invest in foreign shares. In so far as the shareholding gives the shareholder control over the company it is also a restriction of the freedom of establishment of Art. 43 EC.

According to the Commission, the EC Treaty obliges Member States to apply to inbound dividends the same system that they have to avoid double taxation on domestic dividends. The ECJ has interpreted the EC Treaty accordingly in the *Manninen case (C-319/02)*. The subject matter of this complaint is comparable to that of a request for a preliminary ruling, which is still pending before the ECJ, namely the *Kerckhaert-Morres case (C-513/04)*. A difference with that case is that it concerns French dividends, paid at a time when France still paid out a credit for French corporation tax to Belgian investors, making it more attractive for Belgian investors to invest in France than in Belgium.

The Commission considers that the difference in treatment between domestic and inbound dividend is contrary to the freedom of establishment and the free movement of capital, guaranteed by the EC Treaty. The request is in the form of a Reasoned Opinion under Art. 226 EC. If Belgium does not reply satisfactorily to the Commission within two months, the latter may refer the matter to the ECJ.
-- Caroline Goemaere and Laurens Narraina, Belgium; laurens.narraina@pwc.be

**Belgium – Commission requests Belgium to end discrimination on personal tax deductions for residents with foreign source income**

On 20 July 2006, the European Commission sent Belgium a formal request to amend the legislation according to which Belgian residents with both Belgian and foreign income are discriminated by not benefiting from a full deduction of personal and family allowances.

The Commission considers that this limited deduction of personal allowances is contrary to the EC Treaty. On the basis of a case decided by the ECJ concerning identical rules in the Netherlands in the De Groot case (C-385/00), the Commission holds that the unavailability of full personal deductions contravenes the free movement of workers and self-employed persons guaranteed by Art.s 39 and 43 EC and the corresponding provisions of the EEA Agreement and the right of every EU citizen to move and reside freely within each Member State under Art. 18 EC.

The Commission request is in the form of a Reasoned Opinion under Art. 226 EC. If Belgium does not reply satisfactorily to the Commission within two months, the latter may refer the matter to the ECJ.
-- Caroline Goemaere and Laurens Narraina, Belgium; laurens.narraina@pwc.be

**Luxembourg – Commission rules that the Holding 1929 tax regime constitutes State aid**

On 19 July 2006, the European Commission notified the Luxembourg Government of its decision that the Luxembourg tax regime applicable to “Holding 1929” companies constitutes State aid and that it is in breach of Art. 87 EC. This decision concludes a six-year investigation procedure. Although it condemns one of Luxembourg’s oldest regimes, it neither puts an end to Luxembourg holding companies altogether, nor jeopardises the position of Luxembourg in international structuring.

The benefits of the 1929 holding company regime can no longer be granted to new beneficiaries. The Luxembourg Government will abolish the regime by 31 December 2006 at the latest. Existing

1929 holding companies will nevertheless continue to benefit from this favourable tax regime until 31 December 2010, subject to the provision that their capital is not transferred. Following the Government's statements, companies incorporated before 1 August 2006 should benefit from the transitional period.

Clearly, the transitional period is granted due to the longstanding nature of the regime and related expectations of all interested parties, so as to enable a reorganisation of the regime and avoid any adverse impacts that an overnight elimination of the regime would undoubtedly have. It seems fair to impose restrictions to avoid the trading of existing 1929 holding companies, which would unduly extend the benefit of the transitional period to new investors. But these restrictions should not challenge legal certainty. Restrictions should be limited to abusive situations, e.g. where there is a change of control over the company mainly for the purpose of becoming the buyer benefiting from the 1929 regime. On the contrary, non-abusive situations, e.g. transfers of shares of listed companies, intra-group transactions, as well as transfers within a family context, should be left out of the scope of the restrictions. This interpretation seems in line with the Luxembourg Government's statements (this is clearly the case concerning the listed companies).

The Commission's Decision has no retroactive effect; in other words, beneficiaries of the regime do not need to repay the State aid deemed to be received. Existing companies can therefore continue to enjoy the benefits of the regime until 31 December 2010.

The Luxembourg Government has announced its intention to introduce an alternative regime for private wealth management in compliance with Community legislation. Foreign experiences could serve as a guide for the new vehicle. Due to EU constraints and considering that it will be geared towards individuals only, this new vehicle will not offer a complete alternative to 1929 holding companies. However, Luxembourg also offers other opportunities within the existing tax and legal framework for multinational companies currently using 1929 holding companies.
-- Christian Hannot, Luxembourg; hannot.christian@lu.pwc.com

**Italy – Commission issues Reasoned Opinion to Italy for refund of unduly paid taxes: Commission v Italy case (C-129/00)**

On 11 July 2006, the European Commission sent a Reasoned Opinion to Italy for not having introduced national measures for implementing the ECJ's decision in the Commission v Italy case.

In 2000, the Commission referred Italy to the ECJ for certain aspects of the Italian law concerning the refund of unduly paid taxes (customs import duties, manufacturing taxes, consumption taxes, tax on sugar and State duties) levied under national provisions incompatible with Community Law. On 9 December 2003, the ECJ judged that the refund system of unduly paid taxes in Italy was established and applied by the administrative authorities and a substantial proportion of the courts (including the Italian Supreme Court) but in such a way that the exercise of the right to repayment of charges levied in breach of Community Law was made excessively difficult for the taxpayer. The main difficulties related to the conditions which the Italian law required in order to prove that the burden of proof of the tax had not been passed on to other persons.

After the Judgement, in 2004, Italy repealed the Ministerial Guidance concerning the interpretation in breach of Community Law but it has not issued any law to establish new principles relevant to the refund of unduly paid taxes since. Since Italy has not enforced new legislation which effectively bans the recourse to any presumption in order to give evidence that the burden of proof has not been passed to another person, the Commission sent Italy a Reasoned Opinion according to Art. 228 EC.

Italy, considering that it has not introduced measures implementing the judgement of the ECJ (C-129/00), could be referred to the ECJ by the Commission. In order to avoid onerous financial penalties (computed on a day-by-day basis), it is assumed that Italy will probably issue a law to introduce measures regularizing its position in the near future.
-- Claudio Valz, Italy; claudio.valz@studiopirola.com

**Italy – Commission refers Italy to ECJ for failure to amend the Parent-Subsidiary Directive**

Italy has been referred to the ECJ by the European Commission for failure to adopt and notify the measures required for the implementation of Directive 2003/123/EC amending the Parent-Subsidiary Directive (90/435/EEC).

Directive 2003/123/EC is designed to broaden the scope and improve the operation of the Parent-Subsidiary Directive that exempts from withholding tax dividends paid by a subsidiary located in a Member State to its parent company located in another Member State. The amending Directive requires:

- updating the list of companies covered by the 1990 Directive;
- relaxing the conditions for exempting dividends from withholding tax by reducing the participation threshold that establishes a parent-subsidiary relationship; and
- eliminating double taxation for subsidiaries of subsidiary companies.

Although the above provisions of the amending Directive should have entered into force on 1 January 2005, at present only the first provision relating to the list of companies has been implemented. At the same time, the Parent-Subsidiary Directive is already applicable to the European Company and European Cooperative Society, as the Italian law directly refers to the annex of the Parent-Subsidiary Directive as amended by the Directive 2003/123/EC.

The Italian Law Decree n. 223/2006, which has been recently issued, provides for coverage of the costs (less withholding tax obtained by Italy) required for implementing Directive 2003/123/EC. It is assumed that the amending Directive will be implemented in the near future.
-- Claudio Valz, Italy; claudio.valz@studiopirola.com

**Portugal – Commission refers Portugal to ECJ over discriminatory taxation of foreign banks**

In December 2005, the European Commission issued a Reasoned Opinion to Portugal in order to ask for an amendment to Portuguese tax law regarding the taxation of outbound interest payments, which was considered discriminatory on the following grounds.

According to Art. 80 (2) (c) of the Portuguese Corporate Income Tax (CIT) Code, a withholding tax of 20% shall apply to the *gross* amount of interest paid by Portuguese resident borrowers to non-resident lenders, as non-resident banks are not allowed to deduct respective funding costs. On the contrary, interest paid to resident financial institutions shall not be subject to withholding tax, but only to CIT, meaning that net interest received will be subject to Portuguese corporate income tax. Thus, in most cases, foreign banks pay a higher tax in Portugal than Portuguese institutions on the interest received in connection with loans made to Portuguese borrowers and the Commission considers that the higher taxation of foreign banks restricts the freedom to provide services by discouraging Portuguese borrowers from taking out cross-boarder loans. Additionally, Portuguese law on this matter also restricts the free movement of capital, as foreseen in the EC Treaty.

Since Portugal has neither amended its tax law nor responded satisfactorily to the above-referred Reasoned Opinion, the Commission has decided to take Portugal to the ECJ over discriminatory taxation of foreign banks, under Art. 226 (2) EC. The Commission considers that Portuguese tax

rules for domestic and foreign lenders should be harmonised. A similar stance was adopted by the ECJ in the *Gerritse case (C-234/01)* ruling that insofar as resident artists were allowed a tax deduction for their costs, such deduction should also be granted to non resident artists. It is therefore expected that the ECJ will follow the Commission as to what concerns Portuguese tax treatment of outbound interest payments.
-- Leendert Verschoor, Portugal; leendert.verschoor@pt.pwc.com

**Portugal – Commission requests Portugal to repeal tax exemption on capital gains from public undertakings**

In October 2004, the European Commission started a formal procedure including an investigation into Art. 25 of the Portuguese Tax Benefits Statute. Based on this Art., companies with exclusively public capital and companies in a controlling relationship with them can exclude from their taxable profit, capital gains derived from privatization operations and from restructuring processes carried out in accordance with strategic guidelines in the performance of the State's shareholder function and recognised as such by the Minister of Finance.

The Commission holds that Art. 25 of the Portuguese Tax Benefits Statute confers a selective tax advantage to certain companies, which cannot be justified by the general logic of the Portuguese tax system. This Commission considers that as this affects EU trade and distorts competition, Portugal has unlawfully implemented Art. 25 and will have to discontinue both the scheme and recover the aid already granted under the provision.

The Commission investigation concluded that in three out of the four cases where the referred Art. has been applied, the transaction would have been exempted under the normal tax regime. Consequently, only the aid granted to the fourth transaction, concerning the capital gains realised upon the sale of the participation of Caixa Geral de Depósitos, a Bank largely owned by the Portuguese State, in the Brazilian bank Itaú, will have to be recovered.
-- Leendert Verschoor, Portugal; leendert.verschoor@pt.pwc.com

**Spain – Commission takes Spain to the ECJ over infringement of Capital Duty Directive**

The Directive on Indirect Taxes on the Raising of Capital (69/335/EEC), also referred to as "Capital Duty Directive", gives Member States the right, but not the obligation, to impose capital duty at a maximum rate of 1% on the incorporation of a company in that Member State. According to the European Commission, some aspects of the Spanish legislation are not in line with this Directive.

On 13 July 2005, the Commission sent Spain a formal request to amend the contested legislation, as the second step in an infringement proceeding. As Spain did not comply, the Commission was enabled to refer the case to the ECJ, which it has done now. Given that the Directive allows only the Member State where the company is incorporated to levy capital duty, the Commission considers that Spain infringes the Directive on the following points:

- The levying of capital duty on the transfer of the registered office or the effective centre of management of a company from another Member State to Spain, if the creation of the relevant company has not been subject to capital duty in the other Member State;
- The levying of capital duty on capital used for trading operations carried out by Spanish branches and permanent establishments of companies created in other Member States which do not levy capital duty;
- Spain only exempts certain reorganisation transactions, whereas all such transactions should be deemed covered by the Directive;

- Spain exempts the exchange of shares where a company receives at least 75% of the issued share capital of another company. However, if that company subsequently acquires further shares, this transaction is subject to capital duty.

Even though the Government submitted a significant tax reform proposal to the Parliament early this year, the Capital Duty legislation was not included in the proposed amendments. We would like to highlight the importance of the Spanish taxation of transactions which are not subject to this tax in other EU Member States, in so far as Capital Duty has recently been suppressed in several EU jurisdictions. On the basis of this ECJ referral, taxpayers are well advised to consider their position regarding the filing of protective claims to ensure that their rights under Community Law are not jeopardised by a hypothetical time restriction in the event of a favourable judgment by the ECJ.
-- Carlos Concha Carballido, Ramon Mullerat and David Benito, Spain;
carlos.concha.carballido@es.landwellglobal.com

**Spain – Commission requests Spain to end infringement of the Parent-Subsidiary Directive**

The European Commission considers that an anti-abuse clause in the Spanish implementation of the Parent-Subsidiary Directive is disproportionate and should be amended.

The Parent-Subsidiary Directive (90/435/EEC) obliges EU Member States to exempt profit distributions to EU parent companies from withholding tax and allows them to apply anti-abuse measures. The current wording of the anti-abuse clause states that the parent-subsidiary withholding tax exemption shall not apply if a majority of the voting rights in the parent company are held by non-EU residents. This derogation does not apply in the following cases:

When the parent company carries on a business activity related to that of the Spanish subsidiary; or
When the parent company actively manages its interest in the subsidiary, through the use of adequate personal and material means; or
When it is proved the parent company has been incorporated with a sound business purpose and not merely to unduly benefit from the parent-sub withholding tax exemption.

The Commission opines that ECJ jurisprudence has consistently rejected anti-abuse measures which automatically presume abuse without a case-specific examination of the facts and circumstances. The Commission also considers that the Spanish anti-abuse clause may lead to the non-application of the withholding tax exemption to profit distributions to EU parent companies, which in turn do comply with the requirements of the Directive.

The Commission issued a Reasoned Opinion to Spain on 5 July 2006 requesting it to amend this anti-abuse provision. If Spain fails to comply with this request within two months, the Commission would be enabled to take Spain to the ECJ.
-- Carlos Concha Carballido, Ramon Mullerat and David Benito, Spain;
carlos.concha.carballido@es.landwellglobal.com

**Sweden – Commission sends formal request to Sweden regarding free movement of services and free movement of capital**

Sweden has tax provisions stating that foreign financial institutions that are actively marketing their services in Sweden without being established in the country must provide the Swedish Tax Authorities with information regarding their business with Swedish customers. The obligation to provide information comprises dividends and interest as well as other income received from the institution. It also comprises the value of the assets placed with the foreign institution. It should be noted that the same requirements apply also to Swedish financial institutions.

On 29 June 2006, the European Commission sent Sweden a Reasoned Opinion concerning the above mentioned tax provisions. The Commission considers that the requirement tends to dissuade foreign financial institutions from providing cross-border services in Sweden and is therefore incompatible with EC Treaty rules on free movement of services and free movement of capital. The Commission refers to Community Law that provides for exchange of tax information between Member States. This allows Sweden in cases of suspected tax evasion to request for tax information on Swedish citizens from the public authorities of other Member States who would collect the information from their financial institutions under their national rules.

The Reasoned Opinion is the second stage of the infringement procedure. If there is no satisfactory reply within two months, the Commission may refer the matter to the ECJ.
-- Lars Svensson and Gunnar Andersson, Sweden; gunnar.andersson@se.pwc.com

**UK – Commission sends formal request to UK to end discrimination against foreign charities**

The UK tax system offers various forms of relief for gifts to UK charities. The European Commission considers that the UK's denial of tax relief for gifts to charities established in other EU Member States breaches the EU Treaty principles of free movement of capital and of persons, and freedom of establishment. In July 2006 the Commission formally requested the UK Government to amend the relevant UK law.

The request is in the form of a Reasoned Opinion under Art. 226 EC. If the United Kingdom does not reply satisfactorily within two months, the Commission may refer the matter to the ECJ.
-- Chloe Paterson and Peter Cussons, United Kingdom; peter.cussons@uk.pwc.com

## 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).

EU Tax News editors: Irma van Scheijndel, Bob van der Made, Marcel Jakobsen and Peter Cussons.

## EUDTG CONTACT LIST

Leader of the EU Tax Harmonisation Initiative:
Paul de Haan paul.de.haan@nl.pwc.com

**Country contacts**

| | | |
|---|---|---|
| Austria: | Friedrich Roedler | friedrich.roedler@at.pwc.com |
| Belgium: | Laurens Narraina | laurens.narraina@pwc.be |
| Cyprus: | Marios Andreou | marios.andreou@cy.pwc.com |
| Czech Republic: | Hans van Capelleveen | johannis.van.capelleveen@cz.pwc.com |
| Denmark: | Ann-Christin Holmberg | ann-christin.holmberg@dk.pwc.com |
| Estonia: | Aare Kurist | aare.kurist@ee.pwc.com |
| Finland: | Karin Svennas | karin.svennas@fi.pwc.com |
| France: | Philippe de Guyenro | philippe.de.guyenro@fr.landwellglobal.com |
| Germany: | Juergen Luedicke | juergen.luedicke@de.pwc.com |
| Greece: | George Samothrakis | george.samonthrakis@gr.pwc.com |
| Hungary: | Gabriella Erdos | gabriella.erdos@hu.pwc.com |
| Iceland | Fridgeir Sigurdsson | fridgeir.sigurdsson@is.pwc.com |
| Ireland: | Anne Fitzgerald | anne.fitzgerald@ie.pwc.com |
| Italy: | Claudio Valz | claudio.valz@studiopirola.com |
| Latvia: | Zlata Elksnina | zlata.elksnina@lv.pwc.com |
| Lithuania: | Kristina Bartuseviciene | kristina.bartuseviciene@lt.pwc.com |
| Luxembourg: | Christian Hannot | hannot.christian@lu.pwc.com |
| Malta: | Kevin Valenzia | kevin.valenzia@mt.pwc.com |
| Netherlands: | Frank Engelen | frank.engelen@nl.pwc.com |
| Norway: | Anders Heieren | anders.heieren@no.pwc.com |
| Poland: | Camiel van der Meij | camiel.van.der.meij@pl.pwc.com |
| Portugal: | Jorge Figueiredo | jorge.figueiredo@pt.pwc.com |
| Slovakia: | Todd Bradshaw | todd.bradshaw@sk.pwc.com |
| Slovenia: | Janos Kelemen | janos.kelemen@si.pwc.com |
| Spain: | Carlos Concha | carlos.concha.carballido@es.landwellglobal.com |
| Sweden: | Gunnar Andersson | gunnar.andersson@se.pwc.com |
| Switzerland: | Armin Marti | armin.marti@ch.pwc.com |
| United Kingdom: | Peter Cussons | peter.cussons@uk.pwc.com |

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