EU Tax News PricewaterhouseCoopers
EU Direct Tax Group Part of the International Tax Services Network

Issue 2007 – nr. 005 **July – August 2007**

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ECJ CASES

Belgium – ECJ referral regarding withholding tax on interest paid by a Belgian company to a Luxembourg company: Belgian State v Truck Center SA case (C-282/07)

On 13 June 2007, the Liège Court of appeal filed a request for a preliminary ruling to the ECJ with respect to withholding taxation or Belgian source interest paid by a Belgian company to a Luxembourg company.

The Belgian income tax legislation provides for a withholding tax exemption on interest paid to Belgian resident companies. This exemption also applies to interest paid to a Belgian permanent establishment of non-Belgian resident companies but does not apply to interest paid to non-Belgian resident companies not having a Belgian PE. The exemption is however not linked to any Belgian corporate income tax exemption of said income. In other words, even if an exemption is granted to the Belgian company/establishment on interest income, the said income is still subject to Belgian corporate income tax.

The Belgian-Luxembourg Double Tax Treaty (DTT) stipulates that in the case of Luxembourg residents, the Belgian withholding tax retained on interest shall be allowed as a deduction from the tax on the same income levied in Luxembourg. Such deduction is, however, limited to the lower of (i) the part of the tax which is proportionate to the income derived from Belgium and of (ii) the amount corresponding to the Luxembourg withholding tax on similar income paid to residents of Belgium. Moreover, the DTT provides that the Belgian withholding tax shall be deductible from the income taxable in Luxembourg only in so far as it exceeds the Luxembourg withholding tax on similar income paid to residents of Belgium.

With respect to the above Belgian and DTT provisions, the Court of appeal referred the question to the ECJ of whether it is contrary to the free movement of capital (Art. 56 EC) to limit the waiver in respect of withholding tax exclusively to interest allocated to resident companies, as having the effect of discouraging resident companies from borrowing capital from companies established in another Member State and as constituting for companies established in another Member State an obstacle to investing capital, by way of loans, in companies having their seat in Belgium?" See also EUDTG Newsalert NA 2007 – 027.

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Belgium – ECJ judgment on the discriminatory tax treatment of foreign insurance undertakings contributions: Commission v Belgium (C-522/04)

On 5 July 2007, The ECJ ruled that both Art. 59 of the Belgian Income Tax Code (BITC), which denies the deduction of employers' contributions of supplementary pension and life assurance paid to a foreign insurance undertaking or welfare institution, and Art. 145/3 of the BITC, denying the tax reduction for personal supplementary pension and life assurance contributions on the same ground, constitutes a restriction of the freedom to provide services and the free movement of persons. Since Belgium accepts similar deductions for contributions to foreign institutions on the basis of bilateral agreements and administrative circulars, or disallows deduction while taxing income resulting from these schemes, the ECJ held that no justification could be upheld in this case.

In addition, the BITC provisions on the taxation of capital or surrender values built up and transferred to foreign pension funds or insurance undertakings also infringe the freedom to provide services and the freedom of persons, as a similar transfer to a domestic pension fund or insurance undertaking is not a taxable event.

Finally, also Art. 224/2a of the general regulation, requiring foreign insurance undertakings to appoint a representative residing in Belgium to guarantee payment of the tax, is considered an infringement of the fundamental freedoms. The ECJ considered this provision disproportionate as the same result could also be achieved by less restrictive means such as information exchange agreements with the other Member States.

NB: Having anticipated this outcome, the Belgian tax law has been amended in the meantime. See also EUDTG Newsalert NA 2007 – 020.

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Denmark – ECJ judgment on tax evasion and distribution of dividends shortly after tax-exempt exchange of shares: Hans Markus Kofoed v Skatteministeriet case (C-321/05)

On 5 July 2007, the ECJ issued a preliminary ruling on the tax-exempt exchange of shares in response to a referral by the Danish Eastern High Court.

The case concerned two Danish shareholders, Hans Markus Kofoed and Niels Toft, who both owned 50% of the share capital in Cosmopolit Holding ApS. On 29 October 1993, Kofoed and Toft exchanged their shares in Cosmopolit Holding ApS for newly-issued shares in Dooralong Ltd., a company incorporated under Irish law. On 1 November 1993, Dooralong Ltd. received a dividend of IEP 2,742,616 (approx. DKK 26,000,000) from Cosmopolit Holding ApS. On 3 November 1993, the General Meeting in Dooralong Ltd. decided to distribute a dividend of IEP 2,742,116 to Kofoed and Toft. The Danish tax authorities found that the distribution of dividend was made as part of the exchange of shares and therefore that the maximum threshold of 10% of the nominal value of the shares had been exceeded. Consequently, the tax authorities reclassified the tax-exempt exchange of shares as a taxable exchange of shares. The High Court referred the case to the ECJ and asked whether the dividend distributed on 3 November 1993 from Dooralong Ltd. to the owners could be classified as a cash payment when there was no legally binding agreement on the distribution on the date of exchange.

The ECJ held that payment in cash to the shareholders cannot be classified as a "cash payment" merely because of a timing or other link with the exchange of shares. The decisive factor is whether a cash payment resembles a binding agreed consideration which the receiving company must pay as consideration for the contributed shares. The ECJ held that the dividend in the case in question could not be classified as a cash payment.

The High Court also enquired if the tax authorities can react to an abuse of rights - for example, by refusing to grant permission or by withdrawing permission - if Art. 11 of the Merger Directive (anti-abuse provision) has not been implemented in Danish legislation.

The ECJ held that direct implementation of Article 11 is not necessary if Danish legislation otherwise contains a provision or principle containing a general prohibition against abuse of rights or other rules on tax evasion or tax avoidance which can be interpreted in accordance with Art. 11 of the Merger Directive. See also EUDTG Newsalert NA 2007 – 021

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Finland – ECJ judgment on the compatibility of the Finnish group contribution regime with the EC Treaty: Oy AA case (C-231/05)

On 18 July 2007, the ECJ ruled that the Finnish group contribution regime is compatible with the freedom of establishment (Art. 43 EC).

The Finnish group contribution regime provides for a possibility to give a group contribution to another group company if a parent company holds at least 90% of the capital or shares of a subsidiary provided that both companies are taxable in Finland. The contribution is tax deductible for the distributor and taxable for the recipient. In the case of Oy AA, all requirements for a group contribution were met, except for the fact that the recipient of the contribution was not resident in Finland.

First, the ECJ observed that the Finnish regime primarily affects the freedom of establishment so that it must be examined in the light of Art. 43 EC only.

Second, the ECJ stated that the different treatment depending on the place of residence of the parent company constitutes a restriction of the freedom of establishment. The ECJ rejected the argument that a foreign parent company would not be objectively comparable to the Finnish parent company on the ground that a foreign parent company is outside the Finnish tax jurisdiction as a result of which Finland would not be able to check whether the received contribution is taxable at the level of the parent company.

Third, the ECJ found that this restriction of the freedom of establishment is justified by the need to safeguard a balanced allocation of taxing powers between the Member States and the prevention of tax avoidance, taken together, particularly because group contributions are not restricted to the losses of recipients. See EUDTG Newsalert NA 2007 – 022.

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France – ECJ referral on the compatibility of the French group taxation regime with the EC Treaty: Société Papillon case

The French group taxation regime ("*intégration fiscale*") only applies to French companies. Under this regime, the parent company may compensate the profits and the losses realised by the companies of the group and benefit from the tax neutralisation of internal transactions within the group. The parent company must own at least 95% of the subsidiaries, directly or indirectly, through French companies or through French PEs (of foreign companies) that are also members of the tax grouping.

In the present case, Société Papillon – a French parent company – included in its tax group one of its French subsidiaries which was indirectly held through a Dutch company. The French tax authorities, however, denied the tax consolidation.

The administrative Court of Appeal of Paris – without referring the case to the ECJ – held in June 2005 that the condition that all members of the tax group should be subject to corporate income tax in France was compatible with Art. 43 EC (freedom of establishment) and could be justified by the coherence of the tax consolidation regime.

The taxpayer then lodged an appeal with the Administrative Supreme Court (Conseil d'Etat). In its decision of 10 July 2007, this Court decided to refer the matter to the ECJ. Firstly, the Court raised the question of whether the refusal of the tax group regime amounts to a restriction of the freedom of establishment of Société Papillon or its Dutch subsidiary. Secondly, the Court wants to know whether a possible restriction could be justified by the coherence of the tax system or by any other overriding reason in the general interest. If the Dutch subsidiary was considered to belong to the French group - but only for the purpose of indirect ownership of the French lower-tier subsidiary, the question arises whether this would be coherent with the regime of neutralisation of internal transactions within the group. In this respect, the French tax authorities put forward that such possibility may lead to double deductions.

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Germany – ECJ referral regarding the non-deductibility of write-downs in foreign shareholdings in 2001: Steko Industriemontage case (C-377/07)

On 4 April 2007, the German Supreme Tax Court asked the ECJ for a preliminary ruling on the compatibility of the non-deductibility of write-downs in foreign shareholdings in 2001 with Art. 56 EC (free movement of capital).

In the case at hand, a German GmbH wrote its shareholdings in foreign corporations down to the lower going concern value in 2001. The GmbH held shares of less than 10% in the foreign corporations. It is not clear from the facts whether the shareholdings were resident within the EU or in third countries.

With the abolition of the imputation system from 2001 onwards, Germany introduced a tax exemption rule for capital gains resulting from the sale of domestic or foreign shareholdings irrespective of the level of participation in these shareholdings. Corresponding to this, Germany adopted a rule according to which reductions in profits (e.g. write-downs) connected to such shareholdings were not tax deductible, also irrespective of the participation level. In principle, these rules applied from 2001 onwards with regard to participations in foreign corporations and from 2002 onwards with regard to domestic shareholdings.

The earlier application of the non-deductibility of write-downs in foreign shareholdings compared to domestic shareholdings could represent a breach of the freedom of free movement of capital. Due to the fact that this disadvantage for foreign shareholdings was of a temporary nature only, the Supreme Court questioned if this disadvantage would actually deter a potential investor from investing in foreign shareholdings. Furthermore, the Supreme Court considered that the breach of EC Law might be acceptable, since the temporary disadvantage of not considering profit reductions in foreign shareholdings was introduced in connection with the abolition of the German imputation system (which was incompatible with EC Law). In addition, it argued that also the new advantageous regulations, such as the general tax exemption for capital gains from the sale of foreign shareholdings, were already applicable in 2001.

The Court addressed the point that the tax treatment of write-downs in shareholdings within the EU might differ from that of shareholdings in a third country with respect to the Mutual Assistance Directive and the general fiscal supervision, considering that the reasons for a write-down can frequently be derived only from the circumstances of the foreign corporation. Due to the fact that the GmbH held less than 10% of the shares in the foreign corporations, the

Court did not need to discuss the compatibility of the non-deductibility of the write-downs with Art. 43 EC. However, the arguments of the Supreme Court apply also to a potential breach of the freedom of establishment.

The pending case *Gronfeldt and Gronfeldt* (C-436/06), concerned a similar situation regarding taxable capital gains of private persons. In 2001 the lowering of the decisive shareholding from 10% to 1% was only applicable to shares in foreign limited companies. Since 2002 the lowering is also applicable to shares in domestic limited companies.

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Italy – ECJ judgment on the application of the principle of *res judicata*: Lucchini Siderurgica case (C-119/05)

On 18 July 2007, the ECJ ruled that EC Law precludes the application of the principle of *res judicata* in so far as the application of such principle prevents the recovery of a State aid incompatible with the common market.

Differently from the previous judgments issued by the ECJ (such as those ones issued in the case C-126/97 *Eco-Swiss*, C-224/01 *Köbler*, C-453/00 *Kühne & Heitz* and C-234/04 *Kapferer*), the ECJ affirmed the primacy of the EC law over the principle of *res judicata*. This principle, provided for by article 2909 of the Italian Civil Code, precluded the possibility to debate in further proceedings the pleas in law invoked (and those ones which could have been invoked but were not) in previous proceedings which had become final.

In 1985 Lucchini S.p.A. ("Lucchini"), an Italian company operating in the steel and coal sector, applied for aid under Italian Law no. 183 of 1976. In accordance with the EC rules for aid to the steel industry, the Member States are required to notify the Commission of the planned aid measures and to delay their implementation until the Commission has given its opinion. The Italian authorities notified the measure but, without waiting for the Commission's decision, in 1998 granted a portion of the amount applied for.

In 1990, by way of Decision no. 90/555, the Commission stated that the measure was incompatible with the common market. Meanwhile, as the remaining part of aid had not been paid yet, Lucchini had brought proceedings against the Italian authorities in the national civil courts which – without making reference to the Commission's decision – held in 1991 and, afterwards, in 1994 that Lucchini was entitled to the payment of the aid. As the 1994 judgment was not appealed by the Italian authorities before the Supreme Court, it acquired the force of *res judicata*. In 1996 Lucchini received the remaining part of the aid as provided for by ministerial decree.

During the same year the Commission ordered the Italian authorities to recover the aid granted and, consequently, the Italian authorities revoked the ministerial decree and called on Lucchini to pay the aid back. In 1999 Lucchini appealed against this decision before a regional administrative court which declared that the Italian authorities could not revoke their own act as a consequence of the 1994 final judgment. The Italian authorities lodged an appeal with the Consiglio di Stato (higher administrative court) which found a conflict between the 1994 judgment and the 1990 Commission's decision and, therefore, asked the ECJ to determine whether a national authority can recover an aid in contrast with the EC law even in the presence of a national final judgment confirming the obligation to pay the aid.

The ECJ first underlined that national courts do not have the jurisdiction to rule on the compatibility of a State aid with the common market or on the validity of the EC acts; in fact, these assessments fall within the exclusive competence of the Commission. Therefore, in the case at hand, neither did the Italian courts have the jurisdiction to determine if the State aid granted to Lucchini was compatible with the common market nor could they invalidate the 1990 Commission's decision.

The ECJ finally pointed out that the principle of *res judicata* could have the result of attributing to a national judgment effects which exceed the limits of the jurisdiction of a national court, as happened in the present case. In fact, in the case at hand, this principle had the effect of precluding the implementation of the 1990 decision of the Commission which has the exclusive power to assess the compatibility of a State aid with the common market. Therefore, the ECJ concluded that article 2909 of the Italian Civil Code was not applicable.

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Luxembourg – ECJ judgment on negative foreign rental income to be taken into account in the state of employment: Lakebrink case (C-182/06)

On 18 July 2007, the ECJ delivered its judgment in the Lakebrink case in favour of the taxpayer

In the case at hand, the spouses Lakebrink, both German residents and realising the major part of their income in Luxembourg, were taxed at the tax rate applicable for residents based on Article 157ter but a tax loss related to real estate located in Germany was not taken into account for the calculation of the tax rate, on the ground that it did not represent foreign *professional* income. Such loss would however have been taken into account if the spouses Lakebrink were residents.

The ECJ held, mainly on the basis of the *Schumacker* jurisprudence, that due to the fact that the Lakebrinks were deriving almost all of their income in Luxembourg, they were in a situation similar to that of Luxembourg residents for the purposes of the calculation of their tax rate. Indeed, the ability to pay tax may be regarded as forming part of the personal situation of the non-resident within the meaning of the judgment in Schumacker. Therefore, the application of Art. 157ter of the Luxembourg Income Tax Law with the effect of denying non-residents advantages normally granted to residents in a case where the non-residents are in a situation effectively comparable to residents, was considered a discriminatory treatment contrary to the free movement of workers (Art. 39 EC).

Furthermore, the ECJ considered that the argument brought forward by the Luxembourg and Dutch Governments that the situation does not result in a discriminatory treatment because positive foreign real estate income earned by non-residents is not taken into account either for the calculation of their tax in Luxembourg, was not upheld. Unfavourable tax treatment contrary to a fundamental freedom cannot be justified by the existence of other tax advantages. See also EUDTG Newsalert NA 2007 – 023.

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Netherlands – AG opinion in the case of Orange European Smallcap Fund NV (C-194/06)

Orange European Smallcap Fund NV (OESF) is a Dutch resident portfolio investment fund, subject to the Dutch special corporate income tax regime for such funds. This regime provides for (1) taxation of the fund at a rate of 0% and (2) a refund of dividend withholding tax (DWT) to the fund with regard to dividends received by the fund. Dutch DWT is levied upon distribution of dividends by the fund to its shareholders. In 1997, OESF - whose shareholders reside in various (EU and non-EU) countries - received dividends from various countries, including Portugal and Germany. These dividends had been subject to foreign DWT. OESF claimed a refund of those foreign withholding taxes. The refund was, pursuant to Dutch legislation, restricted in two ways. Firstly, no refund of DWT was granted with regard to the dividends from Portugal and Germany, on the basis of the non-existence (in 1997) of tax treaties between the

Netherlands and those countries providing for a right to a credit of foreign DWT against Dutch income tax. Secondly, with regard to the dividends from other foreign countries, the refund of DWT was reduced in proportion to the participation in OESF by shareholders not residing in the Netherlands. OESF claims a full refund of all foreign DWT. The case of OESF ended up at the Dutch Supreme Court, which referred the case to the ECJ for a preliminary ruling.

On 3 July 2007, AG Bot delivered his opinion in this case. With regard to the Portuguese and German dividends, the AG points out that the Netherlands tax both domestic and foreign dividends at a rate of 0%. Hence, the Netherlands treat 'Dutch' dividends on the one hand and Portuguese and German dividends on the other hand equally. Consequently, the disadvantageous taxation of Portuguese/German dividends when compared to Dutch dividends is not a result of Dutch taxation, but a consequence of the exercise of taxing rights by Portugal/Germany (international juridical double taxation). However, the Netherlands do discriminate between Portuguese/German dividends on the one hand and dividends from other foreign countries on the other, since it treats dividends from those respective countries differently. According to the AG, the decision in the D-case does not apply to this differential treatment of dividends from various foreign countries, since (1) the D-case exception to the non-discrimination rule should be interpreted strictly and (2) the differential treatment *in casu* is a result of a Dutch domestic tax rule which is not part of a double tax treaty.

Furthermore, the AG finds the reduction of the foreign DWT refund in proportion to the participation of non-resident shareholders in a portfolio investment fund contrary to Art. 56 EC. After all, the participation of non-resident shareholders reduces the total amount of foreign DWT which is refunded to OESF. This discrimination is not justified by objective differences between resident and non-resident shareholders, since both shareholders are taxed by the Netherlands upon distribution of dividends by OESF.

The AG's analysis is not altered by the fact that OESF has third country resident shareholders. Finally, the AG finds it irrelevant whether the foreign DWT exceeds the Dutch tax levied on dividends distributed by OESF to its non-resident shareholders. See also EUDTG Newsalert NA 2007 – 019

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NATIONAL DEVELOPMENTS

France – Additional administrative guidelines regarding the consequences of the ECJ's Denkavit decision on French dividend withholding tax

On 12 July 2007, the French tax authorities issued additional guidelines (4 C-8-07) regarding the procedure for obtaining an exemption from French withholding tax on dividends paid by French companies to parent companies in the European Economic Area (EEA) except Liechtenstein, following the ECJ decision in the Denkavit case ((C-170/05) of 14 December 2006. The tax authorities already published guidelines regarding this procedure in May 2007 case (see EU Tax News Issue Issue 2007 - nr. 004).

Firstly, the withholding tax exemption applies to companies and other entities registered and effectively managed in the EEA, provided they meet the requirements of the French participation exemption (Art. 145 and Art. 216 of the French Tax Code). In other words, the eligible entities must be subject in whole or in part in their country of residence to corporate income tax at the normal rate. Furthermore, they must hold at least 5% of the capital of the French subsidiary for a 2-year period.

Secondly, French-source dividends eligible for the withholding tax exemption are defined as those eligible for the French participation exemption. The definition of dividends covers various distributions of profits and reserves (including distribution resulting from a capital decrease or a share buy-back, exceptional distributions of reserves and liquidation bonuses).

Thirdly, to benefit from the exemption, the EEA parent company must be unable to offset the applicable French withholding tax. This would be the case when the parent company benefits from a participation exemption regime in its country of residence, or when the parent company is liquidated, or, when the parent company is in a loss position that cancels out any carry forward of foreign tax credits corresponding to the French withholding tax.

Finally, regarding the administrative process, at the request of the French tax authorities, French distributing companies must provide an attestation (and justifications) from the foreign parent company whereby the latter certifies that it meets the conditions for the exemption. The parent company and the distributing company must also be able to prove that the transaction does not constitute an artificial arrangement.

As previously indicated in their first guidelines, the French tax authorities consider that this new withholding tax exemption applies as from 1 January 2007. We are of the opinion that a claim for refund can nevertheless be filed up to 31 December 2008 in respect of withholding taxes paid in France as from 1 January 2003.

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Germany – Non-deductibility of loss attributable to foreign income pending with the German Supreme Tax Court (I R 16/07)

According to German tax law, loans given by a partner to a partnership in which he holds an interest are treated as part of his assets in the partnership (*Sonderbetriebsvermögen*). Such receivable and interest paid thereupon are shown on a separate balance sheet of the partner (*Sonderbilanz*).

In a case decided by the tax court of Muenster, a partner in a German partnership suffered a loss on such receivable. The partnership had used the loan to finance a Spanish hotel business. The tax authorities taxed the partner for the interest but denied the deduction of the loss incurred upon sale of the receivable, to the extent it exceeded the taxable interest. The court upheld the tax authorities' decision but referred the case to the German Supreme Tax Court.

The Supreme Tax Court has repeatedly decided that interest such as referred to above on the separate balance sheet of the partner in a partnership is to be treated as interest under Art. 11 and not as business profits under Art. 7 of the OECD Model Convention. Further, the loan to the Spanish business was not attributable to the Spanish PE in the sense required under the Spanish-German tax treaty. Art. 11 p 1 of the treaty grants Germany the right to tax the interest. Equally, the loss on the receivable is deductible in Germany under Art. 13 p. 3 of the treaty. In respect of the losses however, German national law has to be considered. Section 2a of the German Income Tax Act states that negative income derived from certain foreign - so called passive, including hotel business - investments is non-deductible. Even though the loan was not attributable to the Spanish permanent establishment for treaty purposes, it was attributable to the foreign income for the purpose of Section 2a, since it was used to finance this business. The Supreme Tax Court has in a similar case decided that the treaty classification is not necessarily corresponding to the national one. However, that case concerned a foreign rather than a domestic partnership.

The court doubted if this treatment - i.e. taxation of the interest, but non-deductibility of the loss on the receivable - is in line with EC Law. It referred to the ECJ judgment in the *Ritter-Coulais* case, where the ECJ stated that it infringes EC Law to include foreign positive, but to exclude foreign negative income for the tax rate progression (EU Tax News 2006 - 002). However, the court stated that it is not obliged to refer cases to the ECJ and referred the case to the Supreme Tax Court instead, also in order for the Supreme Court to decide if it upholds its previous case law in this respect.

Section 2a Income Tax Act was subject to decision both in the *Ritter-Coulais* and the *Rewe Zentralfinanz* cases (EU Tax News 2007 - 003) and was in both ECJ judgments deemed incompatible with EC Law. From that point of view, it is difficult to see why the court took such a restrictive view. The referral to the Supreme Tax Court was on the other hand necessary, since the court wanted a clarification of national law.

Additionally it should be mentioned that the result of the non-deductibility of the receivable loss in Germany is that it would not be recognised anywhere, which corresponds more or less with the question pending in the *Deutsche Shell* case (EU Tax News 2006 - 004).

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Netherlands – AG advises to refer Dutch fiscal unity case to ECJ (case 43 484)

X B.V. (X) is a company incorporated under Dutch law and resident in the Netherlands for tax purposes. X holds all shares in Y N.V. (Y), a company incorporated under Belgian law and resident in Belgium for tax purposes. Y does not have a branch in the Netherlands and is not liable to tax in the Netherlands. X filed a request with the Dutch tax authorities to include Y in a fiscal unity for Dutch corporate income tax purposes. Under the Dutch fiscal unity regime, the results of the companies that form part of the unity are calculated on a consolidated basis, which (among others) implies that (1) losses of one company can be offset against profits of another company; (2) intercompany transactions between fiscal unity companies are not visible for tax purposes; (3) the fiscal unity companies can file one corporate income tax return for the entire unity. X especially wants to benefit from the advantage of setting off 'Belgian' losses incurred by Y with 'Dutch' profits realised by X. The Dutch tax authorities denied X's request, since the Dutch corporate income tax rules do not provide for the inclusion of non-resident companies in a Dutch fiscal unity. Such inclusion is only possible insofar as the non-resident company has a PE (branch) in the Netherlands. X appealed against the tax authorities' decision.

The Dutch lower Court (*Rechtbank Arnhem*) rejected X's appeal. It held that the Dutch regime is not in breach of Art. 43 EC (freedom of establishment), referring to the *dictum* in the *Marks & Spencer* case (C-446/03). X took its case to the Dutch Supreme Court. X has argued that the *Marks & Spencer* decision is not decisive for the Dutch fiscal unity regime, which – other than the UK group relief scheme – provides for a full consolidation of the subsidiary's assets, liabilities and results. The Dutch legislation contains a distinctive treatment of (1) Dutch resident parent companies with Dutch resident subsidiaries *versus* Dutch resident parent companies with non-resident subsidiaries and (2) Dutch resident parent companies with non-resident subsidiaries *versus* Dutch resident parent companies with non-resident branches. Both distinctions should constitute a restriction on the freedom of establishment. According to the Dutch State Secretary of Finance, the distinctive treatment contained in the Dutch fiscal unity rules is justified, since the refusal to include non-resident companies in Dutch fiscal unities serves: (1) to preserve a balanced allocation of taxing rights; (2) to avoid double dipping; (3) to combat tax avoidance. According to X, these *Marks & Spencer* justifications are irrelevant. If a non-resident subsidiary were to be allowed to join the fiscal unity of a Dutch resident parent, the non-resident subsidiary would be treated as a branch for Dutch tax purposes. The Dutch rules regarding (1) the claw-back of foreign branch losses and (2) the avoidance of abuse regarding such losses would then unlimitedly apply. Consequently, there could be no imbalanced allocation of taxing rights, double dipping or tax avoidance.

On 4 July 2007, the Dutch AG Wattel issued his opinion in this case adopting most of the arguments put forward by X. However, he thinks the case is insufficiently clear to be decided without a referral to the ECJ, due to the fact that Y can offset its losses in Belgium. Therefore, his advice to the Dutch Supreme Court is to refer the case to the ECJ for a preliminary ruling. See also EUDTG Newsalert NA 2007 – 025.

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Norway – Lower court judgment on time-limits which apply to Fokus Bank case refund claims

On 11 July 2007, in the so-called pilot cases dealing with time limits which regulate refund claims based on the Fokus Bank case, the lower court in Oslo held that the six-month time limit in the Norwegian Tax Payment Act, for bringing a tax decision in before the courts was applicable. The time limit usually starts when the tax lists are made available for the taxpayers. All claims brought forward before the court were therefore time-barred.

The result is the opposite of what the lower court in Oslo ruled in a similar case in January this year. It should in this regard also be pointed out that the claims in both cases were refund claims going back more than three years in time. The tax authorities argue that older claims are time-barred, a view which is not shared by the taxpayers. Foreign and Norwegian taxpayers have filed a great number of court cases against the Norwegian State relating to the time limit issue as a consequence of the judgment in the Fokus Bank case. A sort of consensus has been reached between the lawyers representing the taxpayers and the Attorney-General that only a few test cases will be tried before the courts (pilot cases) and the outcome of these will serve as guidance for the other cases.

The previous Norwegian imputation tax rules were only available to shareholders resident in Norway receiving dividends from companies resident in Norway. In the Fokus Bank case, it was stated that foreign shareholders to Norwegian companies were discriminated against when a withholding tax was imposed on them on dividends. The same applied to shareholders resident in Norway who received dividends from foreign companies. The latter was admitted by the Ministry of Finance after the Fokus Bank case and the imputation system was replaced by a participation exemption method.

The pilot cases consist of both types of claims mentioned above. There is little doubt that the rules were discriminatory which both parties agreed upon in the pilot cases. However, what they disagree on are; (i) the legal basis for the refund claims (condictio indebiti or tort liability based on either Norwegian or EC law) and (ii) the time limit for filing the case. The Supreme Court has stated that the six month time limit will not be applicable if the “fault” could be allocated outside of the tax decision made by the case handler at the tax office.

The court held that the six months time limit was applicable if the legal basis for the refund claims was condictio indebiti. The reason used by the court was that the local tax office had interpreted the tax rules incorrectly and that loss incurred was a direct consequence of a “fault” made when the tax decision was made.

There are several problems with the reasoning given by the court and the first is that all tax provisions will only appear in specific tax decisions making it almost impossible for the State to be liable for its non-compliance with the EEA Agreement. The second is that there is little to blame the local tax offices which merely followed clear provisions in the General Tax Act and instructions from the Ministry of Finance, both formal and informal, that the EEA Agreement which is implemented as Norwegian law would have no bearing when interpreting the General Tax Act. It is more natural to say that the "fault" is first and foremost made by the Norwegian parliament and the government rather than the local tax office. The latter's fault is more of a logical consequence of the system and not the origin of the fault, which makes this part of the judgment rather questionable.

The second legal basis, tort damages, was also discussed by the court. The Supreme Court has already stated that the six months time limit is not applicable for tort damages claims, which means that the general time limit provisions were applicable. The discussion in the judgment was mostly devoted to the tort damages question and especially the basis of liability.

The court held that State was not liable for tort damages based on EC Law because among others: (i) the freedom of capital movement is an unclear rule, (ii) the rules give the National state a large degree of freedom when implementing it (discretionary powers) and (iii) that the rule's applicability on dividend income taxation only became visible around 2004 when Norway altered the imputation rules.

It is difficult to follow this line of argument given by the court. The freedom of capital movement is a clear rule. It prohibits member countries treating residents in other member states less favourably than its own residents when dealing with capital transactions. There is no discretionary power given to the member states with respect to this freedom. All restrictions, direct or indirect, are prohibited. The applicability of the four freedoms on tax regulations was first stated by the ECJ in its judgment in the *Avoir Fiscal* case. The applicability on dividend income tax rules was stated by the ECJ as early as 2000 in the *Verkooijen* case.

The pilot cases have been appealed to the High Court.

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Poland - Exemption from real estate tax for investors

On 23 July 2007, the Polish Government adopted a Decree on the terms for granting regional aid by the local authorities in the form of an exemption from real estate tax. The Decree came into force on 16 August 2007. It allows local authorities to avoid long notification proceedings within the European Commission to get its approval for the relevant resolutions. According to the Decree the value of the aid in the form of the real estate tax exemption depends on the region where the investment is located, i.e. is based on the regional aid map. The aid is calculated on the basis of:

- the costs of investments in fixed assets and intangibles related to a new investment, or
- the employment costs of newly created jobs directly related to the new investment project - depending on the investor's choice.

The Decree stipulates a number of prerequisites for granting the aid which, in principle, follow the common regional aid rules. The aid scheme introduced by the Decree will remain in force until 31 December 2013.

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UK – Sempra Metals Limited v Inland Revenue Commissioners and another: House of Lords awards compound interest

In 2001, the ECJ decided in the joined Hoechst and Metallgesellschaft cases that the inability of a UK subsidiary to enter into a 'group income election' with its EU parent company (where such an election could have been entered into with a UK parent company), such that advance corporation tax (ACT) was payable on dividends to EU parents, but not on dividends to UK parents, was contrary to the freedom of establishment provisions of the EC Treaty.

In the Sempra Metals (formerly Metallgesellschaft) case, the UK House of Lords (the UK supreme court) has now upheld decisions from the Court of Appeal and High Court that compensation for an ACT-related timing disadvantage suffered because the company had a non-UK parent must carry compound interest, not just simple interest as HMRC had contended. This has implications for all successful group litigation orders (GLOs) where restitution is ordered for tax paid and other costs incurred in contravention of a directly applicable fundamental freedom in the EC Treaty. Such restitution must include compound interest on the principal amount (normally tax collected in contravention of the fundamental freedom).

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UK – Vodafone 2 v The Commissioners of Her Majesty's Revenue and Customs: Referral to ECJ to be withdrawn

In 2005 the Special Commissioners (SpCs) referred the Vodafone 2 case to the ECJ for a preliminary ruling on the compatibility of the UK's controlled foreign company (CFC) regime with the EC Treaty. HMRC sought to appeal the decision, but their appeals were dismissed. However, following the ECJ's decision in the Cadbury Schweppes case, the ECJ asked the SpCs if they wished to maintain the referral. The SpCs have now concluded that it is no longer necessary to refer the Vodafone 2 case to the ECJ in the light of the Cadbury decision. The Presiding Special Commissioner, via his casting vote, held that it is possible to "read down" the UK CFC motive test, to comply with the ECJ's judgement in Cadbury Schweppes plc that UK CFC rules should only apply where there are "wholly artificial arrangements". However, the ECJ will not be notified of the decision to withdraw the reference until it is clear whether this latest decision of the SpCs will be appealed (although this seems highly likely) and that appeal has been determined.

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EU DEVELOPMENTS

European Commission opens infringement proceedings against Finland and Italy over discriminatory taxation of dividend and interest payments to foreign EU pension funds

On 23 July 2007, the European Commission announced that it would open infringement proceedings against Finland and Italy for their discriminatory taxation of dividend and interest payments to foreign EU pension funds. Both Member States have two months to reply in a satisfactory manner to the Commission's formal notice.

The Commission's decision follows a complaint lodged with the Commission in December 2005 by the European Federation for Retirement Provision (EFRP). The EFRP concluded that a large number of Member States discriminate against foreign pension funds as they are subject to higher (withholding) taxes on dividends and interest than domestic pension funds. If a Member State acts in such a way it may dissuade foreign pension funds from investing in that Member State. Equally, it makes it more difficult for companies to attract capital from foreign pension funds. According to EFRP, this situation is not justifiable and breaches EC Law, in particular Article 56 EC Treaty on the free movement of capital. The Commission appears to support this view and already sent formal notices to the Czech Republic, Denmark, Lithuania, the Netherlands, Poland (see next item), Portugal, Slovenia, Spain and Sweden on 7 May 2007. The Commission is still examining the situation in Estonia, Germany and France. This may result in the opening of further infringement procedures in October or December 2007. See also EUDTG Newsalerts NA 2007 – 024 and 015.

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Germany – European Commission requests Germany to change discriminatory rules concerning foreign family foundations

On 23 July 2007, the European Commission formally requested Germany to change its system of taxation of non-resident family foundations. According to the German legislation, the beneficiaries of a German resident family foundation only have to pay taxes on benefits actually received from it. However, if the family foundation is domiciled abroad, the annual income of the family foundation is deemed to have been distributed to the founder or to the beneficiaries and is subject to personal income taxation. Thus, the beneficiaries of a non-resident family foundation are taxed irrespective of whether (and to what amount) they actually receive benefits. As a result of this (tax anti-avoidance) provision, the founder or the beneficiaries of a non-resident family foundation will have tax disadvantages compared to a founder or beneficiaries of a German resident family foundation.

The Commission takes the view that this different taxation of domestic and foreign family foundations constitutes a restriction of the free movement of capital, Art. 56 EC, and free movement of persons, Art. 18 EC. The Commission's opinion is supported by the ECJ ruling in the *Cadbury Schweppes* case (C-196/04).

The request was issued under Article 226 in the form of a Reasoned Opinion. If the German legislation is not amended, the Commission may refer the matter to the ECJ.

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Germany – European Commission refers Germany to ECJ over pension allowance: Commission v Germany case (C-269/07)

On 4 July 2006, the European Commission declared that it would refer Germany to the ECJ due to its discriminatory provisions in the tax legislation concerning supplementary pension allowance. The Commission sent a formal request to Germany in 2005 and asked for a change of the legislation, which Germany did not react to.

In the Commission's view, three elements of the legislation are not in line with EU-legislation: 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. Moreover, the allowance (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 for 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 deductibility. Thirdly, the grant must be repaid in case the individual ceases to be subject to worldwide taxation in Germany, i.e. if migrant workers return to their Home State or if individuals migrate upon retirement. In the Commission's opinion, those provisions infringe the free movement of workers in Art. 39 EC and are further not in line with Council Regulation 1612/68 regarding the freedom of movement for workers within the Community (see also: EU Tax News 2006 - 005).

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Germany – European Commission investigates German dividend taxation

According to German law, dividends paid to German resident corporations are exempt from corporation tax, regardless of the amount of the shareholding. At the same time, 5 % of the dividends are treated as non-deductible expense. As a result, dividends paid to German resident corporate shareholders are exempted from corporate taxation to 95%.

However, when dividends are paid to non-resident corporate shareholders, 21.1% withholding tax (including solidarity surcharge) is levied on the gross payment. This tax is reduced to zero if the Parent-Subsidiary Directive is applicable, or if a double tax treaty states a zero rate for qualifying dividends. For other dividends, the withholding tax amounts to between 5% and 15% according to the relevant tax treaties. Thus, such dividends paid to non-resident corporate shareholders are taxed more burdensomely than dividends paid to resident corporate shareholders. In this respect, the German treatment corresponds to the French legislation that was considered to be in breach of the freedom of establishment in the ECJ *Denkavit* judgment (C-170/05; See also EUDTG Newsalert NA 2006 - 035). The Dutch legislation on the same issue is now pending with the ECJ in the *Amurta* case C-379/05 (See also EUDTG Newsalert NA 2007 – 017).

On 23 July 2007, the European Commission formally requested Germany to amend its tax legislation concerning such outbound dividend payments The Commission considers the higher taxation of the outbound dividends to be contrary to the EC Treaty and the EEA Agreement, as it restricts the free movement of capital and the freedom of establishment.

The Commission also sent a Reasoned Opinion to Austria, as the situation there is quite similar to that in Germany. The request sent by the Commission is the second step of the infringement procedure under Art. 226 EC and if both countries do not make the amendments required on this matter within two months, the issue will be referred by the Commission to the ECJ.

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Greece – European Commission refers Greece to the ECJ due to the discriminatory taxation of non-Greek partnerships

On 5 July 2007, the European Commission announced that it had decided to refer Greece to the ECJ due to the Greek tax rules according to which non-resident partnerships in Greece are taxed more heavily (25%) than those resident in Greece (20%). The Commission is of the view that these rules are discriminatory and incompatible with the EC Treaty which guarantees the freedom of establishment.

Under Greek tax legislation, Greek partnerships, are subject to income tax in their name (i.e. they are not transparent). In particular, 50% of the profits of partnerships are taxed in the entity's name at the rate of 20%. In case where there are individual partners, the remaining 50% of the profits is considered as enterpreneur's fee and is deducted from the partnership's net profits for up to 3 individual partners possessing the greatest percentages of participation to the partnership. This fee is determined by multiplying the percentage of participation to the partnership with the 50% of the partnership's net profits, and is further taxed in the partner's name according to the income tax scale applicable to individuals. In case where all partners are legal entities the partnership's total profits are taxed in its name.

On the contrary, branches of foreign partnerships are subject to Greek corporate tax in a way similar to the one applicable to Greek corporations i.e. at the rate of 25%.

The Commission sent a Reasoned Opinion to Greece on 3 January 2007 in which it requested Greece to amend its legislation but Greece did not react. The Commission's case reference number is 2006/2241.

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Greece – European Commission refers Greece to the ECJ due to discriminatory taxation of dividends from foreign companies

The European Commission announced on 5 July 2007 that it had decided to refer Greece to the ECJ because Greece exempts from income tax dividends paid by Greek companies while taxing dividends paid to Greek residents by companies established in other Member States.

Although Greek companies qualifying as parent companies, according to the conditions set by the Parent-Subsidiary Directive, can credit both the withholding dividend tax paid abroad and the underlying corporate tax, Greek companies which do not satisfy the criteria of a "parent company" as well as individuals are entitled only to credit the withholding tax on dividends.

The Commission restricted its investigation only to the individual shareholders. As far as this different treatment is applied from companies established in the EU or in the EEA/EFTA countries, the Commission considers it to be discriminatory and contrary to the EC Treaty which guarantees the free movement of capital (minority shareholding) and the freedom of establishment (majority shareholding).

The Commission sent a Reasoned Opinion to Greece on 18 October 2006. Greece argued in its answer that the individual recipients of inbound dividends are entitled to an ordinary tax credit (i.e. dividend tax paid abroad can be offset against the tax payable on foreign-source income) for any withholding tax effectively paid abroad. However, the Commission considers that, due to the progressiveness of the individual income taxation, the credit method may lead to a higher taxation. The Commission's case reference number is 2006/4044.

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Greece – European Commission requires Greece to recover illegal tax exemptions (State aid)

The European Commission announced on 18 July 2007 that it had decided under EC Treaty state aid rules that tax breaks granted under Greek Law 3220/2004 are incompatible with the Single Market and need to be recovered from the beneficiaries. Under the Law, approximately €200 million of incompatible aid has been given to thousands of companies. Article 2 of Greek Law 3220/2004 allowed companies in certain specific sectors to deduct up to 35% of profits in 2003 and 2004 from their tax base, thus giving them an unfair advantage. These companies could claim this benefit directly from the tax authorities as the aid scheme was part of the Greek tax system.

Irrespective of the fact that the measure was never notified to the Commission and is therefore illegal from a procedural point of view, the Commission also proceeded in the investigation of its substance. Based on its in-depth investigation, the Commission has now decided that the aid is also incompatible with EC Treaty state aid rules (Article 87) because it distorts competition and trade between Member States and that the Greek authorities must recover the aid, plus interest, from the beneficiary companies.

This decision follows one of the first injunctions issued by the Commission requiring a Member State to suspend immediately the granting of state aid before the Commission had taken a final decision on the compatibility of the aid (see IP/05/1325). The Commission at that time considered that the provisional suspension was justified given the continuous application of the tax exemptions by Greece and the increasing distortion of competition in the Single Market.

Following an investigation, the Commission's doubts have been confirmed and it has therefore required Greece to recover the aid from all recipients.

Although many of the activities relate to areas promoted by the EU, the Commission came to the conclusion, that the measure violates the relevant state aid rules in that it gives tax breaks to companies without tying them to the Community objectives that may justify the aid. For regional aid, for example, the beneficiaries are neither obliged to invest strictly into initial investment, nor to maintain the investment in the assisted region.

To re-establish the situation prior to the granting of the aid, the Commission decision requires Greece to immediately and effectively recover the incompatible aid, including interest, from the beneficiaries. Only aid that, at the time of its granting, fulfilled all the conditions of the de-minimis regulations, block exemption regulations or aid programmes previously approved by the Commission does not have to be returned.

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Poland – Government announces amendment to discriminatory rules regarding the taxation of dividend and interest payments to foreign EU pension funds

The Polish Government has replied to the letter of formal notice of the European Commission that was sent to Poland on 7 May 2007 concerning its discriminatory taxation of dividend and interest payments to foreign EU pension funds. Under the Polish corporate income tax law, only Polish-based pension funds are exempt from taxation. As a consequence, dividends and interest received by Polish pension funds are exempt from corporate income tax, whereas similar incomes derived in Poland by EU-based pension funds are subject to Polish withholding tax. The Government now concurs with the Commission's assessment that the Polish law is discriminatory and has committed itself to bringing it in line with EC Law. Consequently, the Government has asked the Commission to suspend the infringement procedure against Poland. See also EUDTG Newsalerts NA 2007 – 015.

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Sweden – European Commission opens new infringement procedure against Sweden over rules on capital gains tax relief on dwelling sales

On 24 July 2007, the European Commission announced that it would start a new infringement procedure against Sweden. Despite an earlier infringement procedure (*Commission v. Sweden*, C-104/06) the Swedish rules on capital gains tax relief on dwelling sales are still not considered to be in accordance with the EU rules on free movement.

Under Swedish tax law, a tax deferral is allowed when replacing the sold private dwelling with a new one. Before December 2006 this deferral was not allowed if the acquired dwelling was situated outside Sweden. As a result of the earlier infringement procedure these rules were extended to also embrace private dwellings situated in another EEC-state. However, which also was pointed out by the ECJ in case C-104/06, the amendments made were not enough to consider the Swedish rules to be in compliance with the rules on free movements of persons in the EC Treaty. Accordingly, a new infringement procedure has been taken by the Commission.

There is still one criterion in the Swedish tax legislation that, in the view of the Commission, discriminates against non-residents. The tax deferral on capital gains deriving from the sale of dwellings is not allowed unless the sold or the acquired dwelling is not owned by a legal form similar to the Swedish *privatbostadsföretag*. In Sweden, most of the entities that own dwellings are regarded as privatbostadsföretag. Consequently, in Sweden there are in most cases no difficulties in fulfilling this criterion. However, outside Sweden, few legal forms can be compared to the form *privatbostadsföretag* which implies a less favourable tax situation when buying or selling an apartment in another Member State.

In the Commission's opinion these Swedish rules constitutes a restriction on the rules of free movements of persons of the EC Treaty. Sweden has to make the amendments necessary or the Commission may send a Reasoned Opinion to Sweden before submitting the issue further to the ECJ.

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Sweden – European Commission to Sweden regarding the rules on tax deductions for non-residents

On 24 July 2007, the European Commission announced that it had sent a Reasoned Opinion to Sweden due to Swedish rules on income tax deductions regarding mortgage interest of non-residents. According to Swedish tax law, earned income of non-residents is taxed in accordance with the Special Income Tax Act for Non-Swedish residents (SINK). A person who is taxed under SINK is not allowed to make any tax deductions on mortgage interest, even though the person receives all or almost all their income from Sweden. In the view of the Commission, this treatment of non-residents under Swedish law is discriminatory and constitutes an unjustifiable restriction of the free movement of persons Art. 18, 39 and 43 of the EC Treaty.

The request sent by the Commission is the second step of the infringement procedure under Art. 226 EC and if Sweden does not make the amendments required on this matter within two months, the issue will be referred by the Commission to the ECJ.

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UK – European Commission sends formal notice to UK regarding cross-border loss relief

Following the ECJ decision in the case of Marks & Spencer plc v Halsey, the UK Government amended the group relief legislation to allow relief for losses of EEA companies provided certain conditions were met. However, it is arguable that certain aspects of the new regime remain contrary to the EC Treaty. We understand that following complaints made by UK representative bodies pursuant to Art. 226 EC, the European Commission has now sent the UK a letter of formal notice.

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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 27 EU Member States, most of the EFTA countries and Switzerland. See the EUDTG website for more information: www.pwc.com/eudirecttax.

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