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ECJ CASES

Belgium – ECJ Judgment on Flemish inheritance tax relief for participations in family companies: Geurts and Vogten case (C- 464/05)

On 25 October 2007, the ECJ ruled that where inheritance tax legislation of a Member State provides for an exemption for such inheritance tax where there is an exclusion for family undertakings which employ in the three years preceding the date of death of the deceased at least five workers in another Member State in contrast to workers employed in a region of the first Member State, such provision infringes the freedom of establishment as laid down in Article 43 EC.

Since an inheritance tax on controlling interests in family companies could threaten the continuation of those undertakings following the death of the director, the Flemish Region of Belgium exempts such shareholdings. This exemption is however only granted if the undertaking employed at least 5 workers in Flanders in the 3 years prior to the death of the deceased.

In the case at hand the deceased, a resident of Flanders, owned 100% of the shares of two Dutch companies that employed more than 5 persons in the 3 years preceding his death. However, since these employees were not employed in Flanders but in the Netherlands, the specific Flemish inheritance tax relief as mentioned above was not granted to the heirs who inherited the shares of the Dutch companies.

The ECJ considers that since the condition to benefit from the inheritance tax relief relates to the employment for a certain period of a certain number of workers in the territory of a specific region, i.e. the Flemish Region, the condition can be fulfilled more easily by a Flemish company than by a company located in another Region or Member State and therefore constitutes an indirect discrimination. The Belgian Government could not provide any valid justification for this restriction. See also EUDTG Newsalert NA 2007 – 037.

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Belgium – ECJ referral on the Belgian dividends-received deduction regime

On 13 September 2007, the Brussels Court of Appeal has referred four questions to the ECJ to clarify whether the Belgian dividends-received deduction regime (DRD) is compatible with primary and secondary EC Law rules, in particular the EU Parent/Subsidiary Directive.

The Belgian tax legislation implementing the Council Directive 90/435 EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (EU Parent/Subsidiary Directive) elected to provide that, where a Belgian parent company receives distributed profits from its EU subsidiary, they are not subject to tax in Belgium. In practice, the Belgian parent is entitled to deduct 95% of the dividend received (the so-called "DRD") from its Belgian corporate income tax base, provided sufficient taxable profit is available. However, if the Belgian parent has insufficient profits or is in a tax-loss position, no deduction is available and any excess DRD is not carried forward to subsequent financial years. The provision applies regardless of the origin of the dividend: Belgium, another EU member state or a non-EU country.

Please note that the Antwerp Court of Appeal already submitted a request to the ECJ for a preliminary ruling dealing with similar issues on 27 February 2007. See also EUDTG Newsalert NA 2007 – 012 and Tax Newsletter 2007 – 003.

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Finland – ECJ judgment on Finnish transfer tax: Fortum Project Finance case (C-240/06)

On 25 October 2007, the ECJ ruled that the Finnish transfer tax is not in breach of the Capital Duty Directive, since this kind of tax is allowed on the basis of Article. 12(1)(a) of the Directive 69/335/EEC concerning indirect taxes on the raising of capital (hereinafter "Capital Duty Directive"). Therefore, the ECJ is of the opinion that Art. 12(1)(c) prohibits only levying of taxes on investments of other property items than securities, real estate, and business asset entities (mentioned in the Art. 12(1) subparagraphs a and b) into a capital company, when consideration is shares in the receiving company.

The case concerned transfer tax liability based on a contribution in kind (the shares in Fortum Heat and Gas Oy) by a Finnish resident parent company Fortum Oyj to a Luxembourg resident Fortum Project Finance SA's share capital. Fortum Oyj would receive newly issued shares in Fortum Project Finance SA as a consideration. According to Finnish domestic tax legislation transfer of ownership in Finnish shares triggers Finnish transfer tax liability for Fortum Project Finance SA.

The Capital Duty Directive regulates on which kind of activities member states are entitled to levy capital duty, other taxes or other payments. Article 12 paragraph 1 includes a comprehensive list of situations where other taxes (than capital duty) may be levied. The list is considered to be an exception to the main rule of prevention of taxation with respect to capital investments. Finnish transfer tax is defined not to be a capital duty, but another tax. According to the Article 12 (1)(a) of the Directive fixed tax or other tax can be levied on alienation of securities. On the other hand, Article 12(1)(c) states that tax can be levied on all kinds of property items that are transferred to a capital company, if the consideration received on the basis of this property contribution is something else than shares in the receiving company. In this case, the whole share capital of Fortum Heat and Gas Oy has been transferred as property item into a capital company Fortum Project Finance SA, and the consideration has been shares in Fortum Project Finance SA. See also EUDTG Newsalert NA 2007 – 036.

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France – ECJ judgement on French 3% tax on real estate held by non-residents: Elisa case (C-451/05)

On 11 October 2007, the ECJ held that the freedom of movement of capital, relevant for real estate investments, prevents the automatic application of the 3% tax to EU entities even where there is no exchange of information between France and another Member State.

The 3% tax is assessed on the fair market value of French real estate owned by non-residents directly or through interposed entities. This tax is aimed at discouraging French resident individuals to transferring their properties to foreign entities, in order to exclude them from the basis of French wealth tax.

This tax is due by non-resident entities located in countries with which France has no exchange of information in place. On the other hand, exemptions apply to entities which disclose name and residence of their shareholders, as long as said foreign entities are covered by a French Double Tax Treaty (DTT) providing for administrative assistance or non-discrimination.

In the case at hand, the interposed entity, Elisa was a Luxemburg "Holding 1929" company, not covered by the DTT between France and Luxembourg and consequently not subject to any administrative assistance. The French tax authorities considered that the 3% tax was due by Elisa because they were not able to check the accuracy of information supplied by Elisa about its own shareholders.

Elisa claimed that the EU Directive of 19 December 1977 provides for mutual assistance between Members States for direct taxes - included wealth tax - and that this Directive should prevail over more restrictive DTT provisions. The difficulty however is that the Directive stipulates that Member States are not forced to communicate any information beyond their own domestic legislation and administrative practice.

The ECJ held that France must *first* request from any EU interposed entity to produce clear and precise evidence of the ownership structure and then collect the 3% tax *only* if and after such evidences have not been produced. Thus, the ECJ considers an infringement of the EC Treaty if an EU entity is presumed to produce erroneous information even though France cannot verify at all the accuracy of information supplied. The 3% tax is considered as a restriction on freedom of movement of capital to the extent that the 3% is due in all such circumstances, and not only in cases of fraud using purely artificial arrangements. See also EUDTG Newsalert NA 2007 – 033.

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Germany – ECJ judgments on German tax deduction for fees to foreign schools: Schwarz / Gootjes-Schwarz (C-76/05) and Commission vs. Germany case (C-318/05)

On 11 September 2007, the ECJ decided two cases on non-deductibility of fees to foreign private schools. The German Income Tax Act allows deduction of 30 % of fees paid to German private schools that are recognised according to the Constitution or by State law. Since foreign schools do not fulfil these criteria, a deduction for such school fees is impermissible.

In *Schwarz / Gootjes-Schwarz*, German parents had sent their children to a Scottish school. Tax deduction for the fees was denied. The ECJ stated that if the offering by the Scottish school constitutes services provided for remuneration, Article 49 EC (freedom to provide services) is invoked. This is the case where the school is mainly financed by private rather than public funds. The ECJ left it to the German court to verify this. If the Scottish school

provided such services, the German rule is in breach of the freedom to provide services: Since it excludes tax deductibility of fees paid to private schools in other EU Member States, it deters taxpayers from sending their children to schools in other Member States and hinders the offering of education by private education establishments in other Member States.

The German Government argued that the breach is justified, since Germany cannot be forced to subsidise other Member States' education systems. The ECJ replied that the rule does not subsidise the school, but is a tax advantage for the parents. The rule also excludes foreign schools merely because they are not resident in Germany, regardless of whether they fulfil the criteria required for a deduction of German school fees.

Even if Germany were right in that each Member State can limit their subsidies so that they do not lead to an unreasonable amount, affecting the overall level of aid the State can grant, the rule is disproportionate. If Germany wants to avoid a too high subsidy, the deductibility can be capped. This would have been more proportionate than excluding deductibility for fees to all foreign schools.

If the freedom to provide services is not applicable, Art. 18 EC (the right to move and reside freely within the EU) leads to the same result, since by moving to Scotland, the children exercise their right to move freely within the EU. The disadvantage of the non-deductibility of the school fees is the result of this.

The ECJ also decided in *Commission v. Germany*, where the Commission had brought the same question to the ECJ. The Commission stated that the German rule infringes both the right to move and reside freely within the EU, the free movement of workers, the freedom of establishment and the freedom to provide services, depending on the circumstances. The ECJ agreed with the same arguments as above and declared that Germany has infringed its EC treaty obligations by denying deductibility of fees paid to foreign schools. See also EUDTG Newsalert NA 2007 – 028.

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Germany – A-G Opinion on German valuation and allowance rules for agricultural land and forestry for inheritance tax purposes: Theodor Jaeger v. Finanzamt Kusel-Landstuhl case (C-256/06)

On 11 September 2007, A-G Mazák opined that the German inheritance tax regulations providing for a different valuation of domestic and foreign agricultural land and forestry is in breach of the free movement of capital. He further stated that a special tax exemption amount existing exclusively for domestic agricultural land and forestry violates the free movement of capital.

For German inheritance tax purposes, agricultural land and forestry situated in another Member State is assessed at fair market values whereas such domestic assets are - due to special valuation rules - assessed at 10% of the fair market value only. In addition, a special tax exemption amount is granted exclusively for the inheritance of domestic agricultural land and forestry. Moreover, the inheritance of such domestic assets benefits from a supplementary reduction of the inheritance tax base to only 60% of the remaining amount.

Inheritance is covered by the scope of the directive 88/361/EEC on capital movements. According to ECJ case law, there is a restriction of the free movement of capital where national rules have the effect that the value of an inheritance of a resident of one Member State is reduced in cases where the assets are situated in another Member State, which taxes the inheritance of those assets. The A-G confirmed such a restriction in the case at hand, as the provisions in question lead to a lower inheritance compared to a pure domestic

inheritance. The A-G denied the several justification reasons given. See also EUDTG Newsalert NA 2007 – 029.

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Germany – A-G opinion on tax exemption for teaching at a foreign university: Jundt case (C-281/06)

Mr. Jundt, a German national, taught part-time for remuneration at Strasbourg University. He applied to have the remuneration partly exempt according to Section 3 No. 26, German Income Tax Act. This was denied since this rule exempts remunerations (up to EURO 1,848) paid for e.g. services to German public law legal persons. Mr. Jundt appealed and claimed that the denial of tax exemption is in breach of the freedom to provide services.

The case was brought to the ECJ and on 10 October 2007, A-G Maduro delivered his opinion.

The A-G firstly clarified the scope of the freedom to provide services. "Services" in this respect means services normally provided for remuneration. Neither the EC Treaty nor ECJ case law indicates that the service provider must be profit-making. "Remuneration" and "profit" are two different concepts and the EC Treaty only refers to the former in describing an economic activity. This cannot be provided for free, but there is no need for the services provider to be profit-making. Thus, the A-G declared that teaching for remuneration falls within the scope of this freedom.

He then stated that the German rule is in breach of the freedom to provide services: Member States may adopt policies to promote education and research in their academic institutions. However, they must do so in a manner compatible with EC Law. The EC Treaty states that "Community action shall be aimed at…encouraging mobility of students and teachers". The German rule is clearly contrary to this as it discourages teachers from teaching in other Member States. Further, even though promotion of education/ research is a legitimate public interest, it appears possible to achieve this aim without artificially distorting the choice for teachers as to where they teach. The German government is indeed right in that Germany is not obliged to subsidise other Member States' academic institutions. However, it is one thing for Member States not to be obliged to subsidise activities in other Member States and quite another thing to deny financial benefits to own and other EU nationals merely because they exercise their EC Law rights.

The referring Court stated that the aim of the rule is to relieve the German State of responsibilities, since on the one hand, tutors are granted tax exemption and on the other hand, the German State benefits since it can cover teaching at a relatively modest price. In the A-G's view, the link between the individual's tax advantage and the State's benefit is too general, vague and remote to establish cohesion as required in ECJ case law. The restriction could thus not be justified.

Finally, it was asked if the rule could be justified as an expression of the Member States' power to decide on the organisation of their education system. The A-G made two comments to this: Firstly, the German rule does not concern the content of teaching or educational system, but is a fiscal measure also applying to other activities but teaching (e.g. charitable work). Secondly, it imposes an artificial obstacle in relation to where tutors offer their services. Accordingly, the A-G - in essence - proposed the ECJ to answer that Art. 49 EC precludes a rule such as the German one.

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Hungary – ECJ judgment on the Hungarian local business tax: Kögáz case (C-283/06)

On 11 October 2007, the ECJ held that the Hungarian local business tax (hereinafter "LBT") is not a similar tax to VAT and thus is not against Article 33 of the EU VAT Directive.

Referring to its judgment in Case C-475/03 (Banca Popolare di Cremona) on the Italian local tax (IRAP), the ECJ repeated that a tax is only against the relevant Article 33 of the EU VAT Directive if it has the same essential characteristics as Value Added Tax (VAT).

According to the ECJ, the Hungarian LBT is not similar to VAT because it is not proportional to the price of goods and services, as LBT is calculated on the basis of periodic turnover. Additionally, simplification rules exist regarding the calculation. For a turnover tax, the amounts paid during the preceding stages of the production and distribution process are deducted from the payable VAT, with the result that the tax applies, at any given stage, only to the value added at that stage, and the final burden of the tax rests ultimately on the consumer. The ECJ stated that only certain costs can be deducted from the assessment base. Therefore, the LBT is not limited to the value added at a particular stage and it is not definite that LBT is ultimately passed on to the final customer. See also EUDTG Newsalert NA 2007 – 032.

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Italy – ECJ judgment on EC contributions: Porto Antico di Genova case (C-427/05)

On 25 October 2007, the ECJ ruled that the Italian corporate taxes levied on the EC contributions do not constitute a deduction or retention prohibited by Article 21(3) of the Council Regulation (EEC) no. 4253/88 (as amended by the Council Regulation (EEC) no. 2082/93). The second subparagraph of that Article provides that "the payment [of EC funds] shall be made to the final beneficiaries without any deduction or retention which could reduce the amount of financial assistance to which they are entitled".

The request for a preliminary ruling under art. 234 of EC Treaty was made in the course of proceedings between the Italian Tax Authorities and Porto Antico di Genova S.p.A., which had brought an appeal before the competent Italian tax courts against the rejection of a claim for the reimbursement of the direct taxes levied on the EC contributions received. The Regional Tax Court of Genoa referred the case to the ECJ, asking whether the Italian tax provision under which EC contributions are taken into account for the purposes of determining the taxable income is compatible with Article 21(3) of Regulation no. 4253/88.

The ECJ held, as it did in Case C-84/04 *Commission v Portugal*, that the prohibition on any deduction set out in Article 21(3) refers to all charges which are directly and inseparably linked to the amounts disbursed. The ECJ, therefore, in line with the A-G Opinion as of 8 May 2007, ruled that the Italian corporate taxes levied on the EC contribution do not represent specific levies directly linked to the financial aid but apply without distinction to all the taxable income of a company. As a consequence, the ECJ concluded that the Italian tax provision which includes the EC contributions in the assessment of the corporate taxable income is compatible with Article 21(3). The ECJ also pointed out that there is no breach of the principle of equal treatment due to the fact that the beneficiaries of EC funds, by reason of the different tax rates imposed by each Member State, actually benefit from a different amount of a same financial aid. The objective disparities existing among the beneficiaries are due to the different rules for assessing the taxable income in each Member State, in the absence of EU harmonisation in this field.

The regional tax court's second question was only relevant in case of incompatibility of the Italian provision. See also EUDTG Newsletter Issue 2007 - nr. 004.

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Netherlands – European Court of First Instance judgment on transitional period for Dutch regime on group financing activities: Friesland Foods case (T-348/03)

On 12 September 2007, the European Court of First Instance ruled in favour of the taxpayer in the case of Koninklijke Friesland Foods N.V. against the European Commission. It partially annulled the Commission's State aid decision of 17 February 2003 concerning the Dutch regime for international financing activities. The Court ordered that all undertakings which as at 11 July 2001 had already lodged a request with the Dutch tax inspector for application of the regime, but in respect of which no formal decision had yet been taken, should be eligible for a transitional scheme.

On 27 December 2000, Friesland Foods lodged a request with a Dutch tax inspector to set up a reserve with effect from 1 January 2000 on the basis of the scheme concerning international financing activities (the GFA scheme). While this request was pending, the Commission notified the Dutch authorities by letter dated 11 July 2001 of its decision to institute the formal investigation procedure with respect to this scheme. On 17 February 2003, the Commission decided that the GFA scheme constitutes State aid which is incompatible with the common market. The Commission also decided that the companies already admitted to this scheme as at 11 July 2001 may continue to benefit from it until 31 December 2010 at the latest. On 21 August 2003, the Dutch tax inspector rejected Friesland Foods' request on grounds that it had not been admitted to the scheme on 11 July 2001, thereby referring to the Commission's decision. On 10 October 2003, Friesland Foods lodged an appeal against the Commission's decision with the European Court of First Instance.

The ECJ held that the Commission's decision runs counter to the principle that legitimate expectations should be honoured. See also EUDTG Newsalert NA 2007 – 030.

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Portugal – ECJ judgment on Portuguese tax treatment of capital gains: Hollman case (C-443/06)

On 28 September 2006, the Supreme Administrative Court referred to the ECJ for a preliminary ruling concerning Portuguese legislation applicable to the taxation of capital gains. According to Article 43 (2) of the Personal Income Tax Code, a 50% reduction applies, among others, to the taxation of capital gains realised by residents concerning the transfer of immovable property (rights) and the disposal in contracts or rights related to immovable property. No such reduction of the taxable base applies to capital gains realised by non-residents, including residents of other Member States.

The ECJ ruled on 11 October 2007 that Article 56 EC (free movement of capital) precludes national legislation such as the Portuguese provision that foresees the reduction of taxation of capital gains realised by residents, considering that such reduction is not applicable to non-residents, as the difference of treatment does not concern situations that are not objectively comparable, nor is justified by overriding reasons in the public interest (Rule of Reason doctrine).

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Sweden – A-G Opinion on the Swedish rules' on taxation of dividend distributed as shares in a subsidiary: A case (C-101/05)

On 11 September 2007, A-G Bot held that the Swedish rules on taxation of dividend distributed as shares in a subsidiary constitute a restriction on Article 56 EC (free movement of capital.

Under Swedish tax law there are rules on subsidiary shares distributed as dividends to a shareholder, implying that that there is no taxation on the dividend distributed. Instead, taxation occurs when the received shares are disposed of. Distributed shares can be of a Swedish or foreign subsidiary (other than in a tax haven), provided that the distributing parent company is a) listed, b) a Swedish company, or c) a foreign company, comparable to a Swedish company, resident in a state within the EEA, or in a state with which Sweden has concluded a tax treaty containing a provision on exchange of information.

In the case referred, a Swedish shareholder, A, holds shares in a Swiss parent company. The Swiss parent company has in turn a Swiss subsidiary. A receives dividend from the Swiss parent company, distributed as shares in the Swiss subsidiary. In this case the conditions under c) are not fulfilled since Switzerland is not an EEA member state and, moreover, the Sweden-Switzerland tax treaty does not contain a provision on exchange of information. A applied for an advance ruling by the National Board on Advance Rulings

The A-G has pointed out that the Swedish rules, which prohibit tax exemption unless the company distributing the dividend is either an EEA-state or a state with which Sweden has a tax treaty containing a provision on exchange of information, constitutes a restriction to the free movement of capital. In the A-G's view, the Swedish legislation can be justified because of the EU member states' need to maintain an efficient tax control system and that the exchange of information is necessary to make sure that the conditions, under which the tax exemption was granted, are truly fulfilled. The A-G also held that this restriction was proportionate to the refused tax benefit. The justification, however, only applies if the resident state cannot, by its own means, maintain the information necessary. See also EUDTG Newsalert NA 2007 – 031.

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NATIONAL DEVELOPMENTS

Finland - Advance Ruling of the Central Tax Board concerning taxation of cross border merger between companies resident in Finland and in an EEA State

On 12 September 2007, the Finnish Central Tax Board handed down an advance ruling on cross border merger between a Finnish and an EEA State resident companies. In the case at hand, a Finnish limited liability company considered merging into its parent company resident in Iceland. In the merger, all assets and liabilities of the Finnish company would remain effectively connected with a Finnish permanent establishment of the Icelandic company. The parties had the intention to carry out the merger as an absorption merger within the meaning of the Directive 2005/56/EC on cross-border mergers of limited liability companies which is applicable in EU Member States as well as in EEA States. At present, the Finnish tax provisions on mergers are applicable only to companies resident in EU Member States. However, taking into account the freedom of establishment as referred in Article 43 EC and Article. 31 of the EEA Agreement, the Central Tax Board decided to tax provisions enabling tax free mergers are also applicable to the merger in question even if the receiving company was not resident in an EU Member State. The advance ruling is applicable to financial years 2007 and 2008.

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Finland – Government bill on amendments to corporate tax legislation to meet the requirements of Directive 2005/56/EC on cross-border mergers of limited liability companies

On 12 October 2007, the Finnish government initiated a bill to the Parliament concerning the amendments of Finnish corporate legislation the purpose of which is to implement the provisions of the Directive 2005/56/EC on cross-border mergers of limited liability companies to national legislation. According to the bill provisions on cross border merger and de-merger are included in the Finnish corporate legislation and legislation regulating financing activities, enabling Finnish companies being part of a cross border merger or de-merger where other parties are companies resident in other EU or EEA member states. The amendments will come into effect on 15 December 2007.

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Germany – Federal Finance Court rejects the appeal in the Scorpio case

On 24 October 2007, the ruling of the German Federal Finance Court (BFH) IR 39/04 dated 24 April 2007 was published. This ruling is the subsequent decision to the ECJ's preliminary ruling in the *Scorpio* case (C-290/04 cf. EUDTG Newsalert NA 2006 - 028) of 3 October 2006 regarding the German withholding tax on certain income of non-residents. The tax is deducted at source on the gross amount, whereas business expenses are not deductible. The debtor of payments is liable for the withholding. However, there is no withholding tax being levied and no liability regarding payments to resident creditors. Furthermore, resident creditors are taxed on the basis of their net income so that they are allowed to deduct business expenses.

The ECJ had held that the withholding of tax at source as well as the incurred liability by the debtor of the payment is compatible with EC Law at least in the year in question (1993). These measures are justified by the necessity to secure the taxation of non-residents: Since in 1993, neither EC Law nor the tax treaty in question provided means for Germany to recover taxes in the state of residence of the service provider; the Directive 2001/44/EC on mutual assistance was implemented not until 2002. Though, business expenses that the provider of the services reported to the debtor of payments are deductible by determining the retention of tax at source.

In the national fiscal court proceedings, the plaintiff requested to annul the notice of liability that was to be incurred due to the omitted withholding of tax at source under Sec. 50a German Income Tax Act (EStG). After failing with the German lower Finance Court, the plaintiff appealed on a point of law to the BFH. The BFH itself asked the ECJ for a preliminary ruling. Although the plaintiff did not appeal to reduce the sum of liability with regard to business expenses, the respective questions for the preliminary ruling are likely to be interpreted as if the deductibility of business expenses was a decisive factor.

After the positive preliminary ruling of the ECJ it is therefore a bit surprising that the BFH rejected the appeal on points of law to be unreasoned. For justification it is stated that business expenses have neither been claimed nor reported by the provider of the services in time. The reporting was only done during the proceedings with the BFH and therefore too late. Please note that at the status of an appeal on points of law, neither further investigation of the facts nor new evidence is allowed. According to the principle of *effet utile* (to the widest extent possible) of EC Law, it is somewhat astonishing, that the BFH did not transfer the appeal back to the Finance Court in order to give the opportunity to report these very business expenses, especially after having asked respective questions for the preliminary ruling.

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Italy – Amendment of the Italian tax legislation concerning outbound dividends

At the end of September, the Board of the Italian Ministers discussed the first draft of the Italian Financial Bill Law for 2008. Among other important tax changes, the draft of the Financial Bill Law provides for an amendment of the Italian tax legislation concerning outbound dividends. In particular, on the basis of the draft law, the withholding tax rate levied on dividend distributions to non-resident companies or entities is still 27% (except for a reduction on the basis of the Tax Treaties) but the rate is reduced to 1,375% if the following conditions are met:

1. the recipient company or entity is an EU or EEA resident;
2. the recipient company or entity is resident in a State included in the list of countries ("white list") that grant the exchange of information (this list must be drawn through the approval of a Ministerial Decree); and
3. the recipient company or entity is subject to corporate income tax in its State of residence.

On the basis of the draft Financial Law, the new withholding tax rate would be applicable to dividends accrued starting from the financial year 2008. The 1,375% rate is the same effective tax rate that would be applied to dividends received by domestic companies. It derives from the application of the corporate tax rate at 27.5% (the new corporate tax rate on the basis of the draft Financial Law) on the fraction of dividends subject to taxation, equal to 5%.

The amendment has been made following the reasoned opinion, sent on 28 June 2006 to Italy, by the European Commission and implicitly confirms once again that the Italian tax legislation on dividends paid to non-resident companies in force is in breach of the EC Treaty. Referring to the entities concerned by the new rule, the draft Financial Law states the application of the reduced rate to non-resident companies and the new regime seems to be also widened to certain entities, like pension funds, which are exempt from taxation in many States.

Given that the draft Financial Law does not deal with the past, non-Italian companies, investment funds, pension funds, holding shares of Italian companies, can still claim back the withholding taxes suffered in the last 48 month on dividend distributions which were exceeding the actual taxes paid by companies, investment funds, and pension funds resident in Italy.

For future years, the approval of the Financial Law would eliminate the discrimination for non-resident companies receiving dividends from Italian companies but the effects for foreign investment funds and pension funds need to be further clarified and, in any case, evaluated on a country by country basis.

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Luxembourg – Draft bill amending the law implementing the Savings Directive

On 27 July 2007, the European Commission sent a formal request to Luxembourg for the amendment of the law implementing the Savings Directive. According to the Commission, the fact that the 10% withholding tax applicable under law by paying agents established in Luxembourg to interest received by resident individuals represents a final taxation of the interest in the hands of the resident individuals, while the interest paid to the same individuals by paying agents located outside Luxembourg are taxable at the progressive rates, is a discriminatory situation, discouraging resident individuals from investing through paying agents located abroad.

In reply to this request, on 20 September 2007, the Luxembourg Ministry of Finance introduced with the Chamber of Deputy a draft bill for the amendment of the law of 23 December 2005. Under the draft bill, resident individual receiving interest from a foreign paying agent can opt for the final 10% tax, to be applied on the amounts that would have been subject to the 10% withholding tax if the paying agent was located in Luxembourg. In such case, the formalities and the payment of the tax that would have had to be carried out by a resident paying agent are transferred to the resident individual. A potential foreign withholding tax retained by the foreign paying agent is creditable against the Luxembourg final 10% tax if covered by a double tax agreement. Under the draft bill, the new regime is applicable to interest income paid after 31 December 2007.

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Norway – Tax exemption method and refund of withholding tax imposed on dividends

On 25 September 2007, the Norwegian Ministry of Finance gave a statement regarding which requirements foreign investment funds (UCITS) resident in the EEA must meet in order to get refund of Norwegian withholding tax imposed on dividends distributed from Norwegian companies. The statement will also be relevant for pension funds, insurance companies, foundations, ordinary corporations and several other types of legal entities.

In 2004, Norway introduced the so-called tax exemption method for income and capital gains on qualifying shares. The tax exemption method applies for corporate shareholders resident in Norway and corporate (companies, funds etc) shareholders resident in other EEA States to the extent that the shareholder is comparable to a Norwegian shareholder covered by the said rules.

The main question raised in the interpretive statement is whether or not foreign investment funds resident in EEA are covered by the tax exemption method. If foreign funds are comprised by the method, they would be exempt from Norwegian withholding tax on dividends distributed from Norwegian companies.

The Ministry of Finance acknowledged that the EEA Agreement is relevant when interpreting the tax exemption method, but stated that it is unclear to what extent the said Agreement protects investment funds.

In the Ministry of Finance's opinion, foreign investment funds should be subject to tax in the EEA country where they are resident in order to be comprised by the exemption method since Norwegian investment funds are subject to tax, in Norway. Further, the Ministry stated that the term "resident" under the tax exemption method should not be wider than the resident concept under the EU Parent/Subsidiary Directive (which Norway has not implemented and has no intention of doing so since it is not a member of the EU). Based on this view, the Ministry stated that foreign funds should be tax resident and liable to tax in their resident country according to their domestic tax law, and also according to the tax treaty between this country and Norway. Furthermore, the Ministry seems to state, with another reference to the EU Parent/Subsidiary Directive that foreign funds should be subject to corporate taxation in their home country without the possibility to be exempt from such taxation.

Finally, the Ministry of Finance stated that the foreign funds must prove that they are the beneficial owner of the Norwegian dividends to be comprised by the Norwegian exemption method. In this regard, it is a requirement that the foreign funds are tax resident both under domestic law and applicable tax treaty to be considered beneficial owner of the Norwegian dividends.

In our view, the requirements outlined by the Ministry of Finance are too extensive according to the domestic tax provision and the preparatory works. When interpreted in the light of the EEA Agreement, there is in our view little doubt that Norway cannot restrict foreign investment funds from the same rights as domestic investment funds only on the grounds that the foreign investment funds are exempt from taxation in their home country. Hence, we still clearly recommend investment funds in the EEA to apply for a refund of Norwegian withholding tax.

-- Aleksander Grydeland, Norway; aleksander.grydeland@no.pwc.com

Portugal – Proposed State Budget for 2008

The proposed State Budget for the year 2008 introduces changes to corporate income tax law to simplify the requirements to be fulfilled for reducing or eliminating the withholding tax rates foreseen in the Portuguese tax law under the application of the EU Directives.

Furthermore, the requirements for the application of the exemption of withholding tax on dividends as foreseen in the EU Parent/Subsidiary Directive have been amended. No withholding tax is due when an EU resident has owned for owned for at least 1 year a 10% participation in a Portuguese entity (or a participation with an acquisition cost of at least € 20 m). The holding period was 2 years. However, as in domestic situations a 1 year holding period applies, this discriminating treatment has now been resolved.

Concerning Personal Income Tax, the State Budget for 2008 has also introduced changes, such as the authorisation for the government to introduce legislation that allows individuals in other Member States to be subject to the tax regime applicable to individuals resident for tax purposes in Portugal.

-- Leendert Verschoor and Jorge Figueiredo, Portugal; jorge.figueiredo@pt.pwc.com

UK - Implementation of Directive 2005/56/EC on cross-border mergers of limited liability companies

Company law regulations which implement Directive 2005/56/EC were laid before Parliament on 16 October 2007 and will come into force on 15 December 2007. Changes to tax legislation relating to EU cross-border mergers have been published in draft for consultation, but the final legislation is not yet available.

-- Chloe Paterson and Peter Cussons, United Kingdom; peter.cussons@uk.pwc.com

UK – Vodafone appeals decision of Special Commissioners

Vodafone are appealing against the 26 July 2007 decision of the Special Commissioners reported in our previous newsletter that the judgment of the ECJ in the Cadbury Schweppes plc case regarding the consistency of the UK motive test with the EC treaty freedom of establishment could be "read down" into UK domestic tax legislation, notwithstanding the complete absence of any reference whatsoever in the UK motive test to the CFC being "genuinely economically established" or there not being "wholly artificial arrangements". The appeal has been listed for hearing before the High Court in May 2008.

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EU DEVELOPMENTS

EU – European Commission issues progress report on probable elements of the proposed Common Consolidated Tax Base

The European Commission has issued its latest progress report on the Common Consolidated Corporate Tax Base (CCCTB).Working Paper 57 entitled: "Possible elements of a technical outline"), was discussed by the Commission and the EU's Member States at the end of September during the CCCTB Working Group meeting. EU Tax Commissioner Kovacs has recently announced that a Directive on the CCCTB will be proposed by the Commission to ECOFIN in September 2008 under the French Presidency of the EU.

For the first time, the Commission has brought the various structural elements of the base together into a coherent proposed set of basic rules for the taxation of individual and consolidated companies, which will serve as the basis for the Directive. At the same time, the Commission acknowledges in its paper that a number of important aspects of the CCCTB are still to be developed further for instance the sharing mechanism (formulary apportionment), how to apply the CCCTB to financial institutions, certain administrative aspects and rules on business-reorganisations and anti-abuse.

The working paper asserts that as IAS/IFRS rules cannot be considered suitable to function as a mandatory common starting point for a consolidated tax base, a complete tax base as well as the scope of participants in the CCCTB will still need to be determined. The EU companies that will be eligible for the CCCTB will be listed in an annex to the Directive, as will companies that are incorporated in third countries which are comparable to the EU companies listed in the annex. Both the EU and third country companies would be subject to an EU corporation tax that will also be added in an annex to the Directive through their incorporation, residency or via the establishment of a permanent establishment (PE) in the EU. It is understood that with regard to a PE of a third country company, the third country company should be comparable to one of the incorporation forms listed in the annex.

With respect to the tax base of the companies, the paper distinguishes between individual and consolidated companies. The working paper envisages optional consolidation of a group of 75% or more owned companies including PEs in another Member State, or, in the case of a holding, of at least 75% of the voting rights, held directly or indirectly (even through companies resident in non-EU member states). As a consequence of the consolidation, specific rules are proposed with regard to changes in the level of individual company ownership, alienation of shares and de-recognition of intra-group transactions.

The option to elect into a CCCTB consolidated group would be on an "all-in" (i.e. no "cherry picking") basis for 5 years, renewable for periods of 3 years, on a rolling basis.

For both individual and consolidated companies, the tax base will be determined by taking into account a broad concept of income and detailed rules with regard to tax-deductible and non-deductible expenses and depreciation of assets. To attribute the income to 12-monthly accounting periods, income and expenses will be recognised on an accruals basis. Specific rules for individual as opposed to consolidated companies are proposed with regard to related party transactions, with the retention of the arm's length principle between individual companies and their related parties (both individuals as well as companies).

It is proposed that overall losses in a CCCTB group are carried forward without time limit at the level of the group, rather than being allocated out to group member companies. However, where a CCCTB group with an unutilised overall loss terminates, the losses would then be allocated out to the former CCCTB group companies.

Finally, the working paper also deals with foreign income and the elimination of economic double taxation thereon. The Commission considers it necessary to distinguish between the treatment of income from within the EU and that from a third country. With regard to intra-Community income, the income will either be consolidated (royalties, interest, portfolio dividends and >/= 75% shareholdings) or exempt (income from shareholdings of 10%-<75%), while a switch over from the exemption to the credit method may apply for third-country income if the corporate income tax rate of that third country is considered to be too low, currently proposed as < 25% of the average rate of corporation tax in the (presumably participating) Member States.

-- Bob van der Made and Frauke Davits, The Netherlands, and Peter Cusssons, United Kingdom; peter.cussons@uk.pwc.com

Germany – European Commission opens infringement proceedings against Germany for its discriminatory rules applied to cross-border loss offset

On 18 October 2007, the European Commission formally requested Germany to change its system on cross-border loss offset referring to Sec. 2a Par. 1 German Income Tax Law (EStG). The provision applies to both resident individuals and companies and restricts the immediate use of their losses from foreign sources.

In general German residents are taxable with their world wide income. Basically, the term *income* also includes losses. Due to Sec. 2a EStG, specific types of losses from so-called passive income generated abroad can only be offset with positive income from the same category and the same state. In comparison with losses generated in Germany, which can be offset without any restriction, the different deductibility of foreign losses leads to a higher taxation.

The Commission takes the view that this different deductibility of domestic and cross-border losses is incompatible with the principle of freedom of establishment and the free movement of capital. Concerning write-downs on foreign participations, as a specific kind of income, the Commission's opinion is supported by the judgment of the ECJ of 29 March 2007 in the *Rewe Zentralfinanz* case (C-347/04, see NA 2007 - 013) and therefore not surprising.

However, in its press release IP/07/1547 the Commission mentions explicitly losses from permanent establishments abroad or from the rental of foreign property and refers to Sec. 2a Par. 1 EStG only. Actually this is a bit surprising, because irrespective of Sec. 2a EStG these kinds of negative income would often underlie a Double Tax Treaty and thereafter would be tax exempt in Germany either. Thus, respective losses are not deductible in Germany under Sec. 2a EStG and under most Double Tax Treaties. At the moment it is not sure, if the Commission took the Double Tax Treaties into account when it opened the infringement proceedings.

With regard to the above mentioned restriction due to the Double Tax Treaty several cases are pending with the ECJ (i.e. *Lidl* case, C-414/06; *Stahlwerke Ergste Westig* case, C-415/06).

The request was issued under Art. 226 EC in the form of a Reasoned Opinion. If the German legislation is not amended, the Commission may refer the matter to the ECJ. See also EUDTG Newsalert NA 2007 – 035.

-- Gitta Jorewitz and Jürgen Lüdicke, Germany; juergen.luedicke@de.pwc.com

Greece – Draft law regarding the recovery of illegal tax exemptions (State aid) introduced before Greek Parliament

Following the European Commission's decision of according to which the tax breaks (tax-free reserves) granted under Greek Law 3220/2004 are incompatible with EC Treaty State aid rules, the draft law regarding the recovery of the State aid was introduced before the Greek Parliament.

According to these provisions, the tax-free reserves formed from the enterprises' undistributed profits of the fiscal years 2004 and 2005 constitute State aid and are subject to tax at the rates applicable at the year of their formation. The State aid's amount equals to the tax amount, which the enterprise did not pay due to the tax free reserve.

The enterprises should file a special income tax return by 14 December 2007 declaring the taxable reserve amount, the corresponding income tax and the interest due. The interest is calculated from the expiration of the deadline for the submission of the respective fiscal year's tax return until 14 December 2007 at the interest reference rate determined by the European Commission.

The tax and interest amount due will be paid in four equal instalments the first of which must be paid at the time of the filing and the other tree on the last working days of January, February and March 2008.

The aforementioned interest is tax deductible from the gross income of the accounting periods during which they are paid.

The abovementioned provisions are not applicable, inter alia, in case where:

- the tax amount corresponding to the tax-free reserves does not exceed Euro 100,000 for each accounting period (de minimis); and
- the State aid may qualify as an incentive according to the provisions of L.2601/1998 or L.3299/2004.

. See also EUDTG Newsletter Issue 2007 - nr. 004

-- Alexandros Sakipis and Stavroula Marousaki, Greece; alexandros.sakipis@gr.pwc.com

Italy – European Commission authorises adoption by Italy of the "*cuneo fiscale*" regional tax reduction measure

On 25 September 2007 the European Commission announced (press release IP/07/1306) that it has authorised Italy to adopt the so-called "*cuneo fiscale*", a tax regime which provides for reductions from IRAP, the regional tax on business activities. The Commission considered that such regime, which became after certain amendments a general measure applicable to the Italian economy as a whole, does not constitute state aid under EC Treaty state aid rules.

IRAP, introduced by Legislative Decree no. 446 of 1997, is a regional tax levied on the net value of production generated by the business activities carried out by individual entrepreneurs, partnerships and companies. According to Article 16 of the mentioned Legislative Decree, the tax is calculated by applying a rate of 4.25% (the rate may vary according to the region where the activity is carried out) to the net value of production which is the difference between revenues and costs, excluding certain items such as labour costs, interest and extraordinary income/costs.

The "*cuneo fiscale*" was introduced by the Financial Bill Law for 2007 (Law no. 296 of 27 December 2006) which established that individual entrepreneurs, partnerships and

companies – excepting banks, insurance companies, companies operating under a government concession or regulated tariff and public administrations – can deduct from the IRAP taxable base:

- Euro 5,000 (alternatively raised to Euro 10,000 for workers employed in certain regions), per year per employee engaged with no time limit, adjusted to the effective number of days of employment during the fiscal year;
- the social security contributions related to pensions, sickness insurance and work accidents for employees engaged with no time limit.

The Financial Bill Law for 2007 also provided that the application of the "*cuneo fiscale*" was subject to the authorisation of the competent EU authorities but this provision was abolished by the Law Decree no. 67 of 28 May 2007 and the deductions became effective for the determination of the 2007 IRAP prepayment from February 2007 at the rate of 50 per cent and from July 2007 at the rate of 100 per cent.

In April 2007, Italy notified the "*cuneo fiscale*" tax regime to the Commission, pursuant to Article 88 (3) EC. After the Commission's request to broaden the scope of the tax measure to the companies which remained excluded by the scheme, Italy decided to extend it to the banking and insurance sectors through the approval of the Law Decree no. 81 of 2 July 2007. Therefore, the only remaining exclusions concern public utilities and public administrations. The Commission considered both the exceptions duly justified as, with reference to public utilities, the exclusion was necessary to avoid overcompensation since the regulated tariff, under which they operate, already takes into account the cost of taxation (including IRAP) while, for public administrations, the exclusion was justified as they are not regarded as undertakings for the purposes of State aid rules given that they do not usually carry out business activities.

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Spain – European Commission opens State aid inquiry into Spanish financial goodwill amortisation

The European Commission has opened a formal investigation into the Spanish financial goodwill amortisation. The first step in this process is a request of information to Spain. The procedure may result in the approval, repeal or gradual phasing out of this tax measure.

The Spanish financial goodwill amortisation became effective on 1 January 2002. When a Spanish resident company acquires shares in a non-resident company, at a price in excess of its net book value, such excess is first allocated to the hidden capital gains that may exist in the acquired assets; the remainder of such excess is considered financial goodwill, which may be amortised for tax purposes over a period of 20 years.

Although the law is silent on this point, the Spanish Tax Authorities have opined that the financial goodwill amortisation should be considered as a temporary, rather than a permanent, adjustment to the taxable income; therefore, in the sense that it should be recaptured upon a future disposal of the shares in the non-resident company.

The preliminary assessment of the Commission contained in the press release issued on 10 October 2007, expresses a concern on whether the financial goodwill amortisation may "provide selective advantages to Spanish companies engaged in acquiring foreign companies and would therefore be susceptible to distort competition. Moreover, the Commission has concerns that the scheme could attract the location of international holding activities in Spain, while the creation of domestic groups seems to be excluded from its scope."

Since Spain does not consider this tax rule to constitute State aid, it did not notify the Commission of its proposed introduction, in order to permit the latter to analyse it under EU State aid rules.

The first stage in the State aid inquiry is an information request to Spain. The procedure should terminate with a Decision issued by the Commission. The opening of the investigation does not prejudice its outcome. The procedure may result in either an acceptance of the legality of the tax rule, an agreement with Spain for a gradual phasing out of the incentive going forward, or a request to Spanish companies that have received such aid to return to the Spanish Treasury the amounts that have been claimed as a deduction, plus interest charges. In the meantime, the Commission may decide that the tax rule should be suspended or that any advantages should be recovered provisionally until the Commission has taken a final decision on the compatibility of the rule with the common market.

Taxpayers which are affected by the Commission's decision to open the formal investigation procedure have the opportunity to submit their comments to the Commission. Both taxpayers and Spain will have recourse to the European Court of First Instance and the ECJ, respectively, once the final Decision is issued. See also EUDTG Newsalert NA 2007 – 034.

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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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