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Belgium – AG opinion on ownership under the Parent-Subsidiary Directive: Les Vergers du Vieux Tauves case (C-48/07)

On 3 July 2008, AG Sharpston published her opinion on whether a company which owns a right of usufruct over shares in another company should be regarded as a parent company within the meaning of Council Directive 90/435/EEC of 23 July 1990 (Parent-subsidiary Directive).

A Belgian court asked the ECJ whether the Parent-subsidiary Directive requires Member States to grant the advantageous tax treatment of dividends received by a parent company from a subsidiary which is required by Article 4(1) in a situation where dividends are received by one company by virtue of a "right of usufruct" while the legal ownership remains with another company.

Under Belgian Law, usufruct means "the right to enjoy things owned by another, as the owner himself, but conditional on preserving the substance". In particular, usufruct over a share confers solely a right to dividends arising from the share. The other rights remain in principle in the hands of the legal owner (rights over reserves, voting rights, right of disposal).

The AG analysed the question based on the aim, the scheme and the wording of the Parent-subsidiary Directive:

Aim: according to the AG, arguments assuming that the type of inter-company relationship which the Directive seeks to encourage is limited to groups in the conventional company law sense should be rejected. In her view, it would be contrary to the aim of the Directive for a dividend received by a usufructuary to be subject to double taxation in circumstances where Article 4(1) of the Directive would require relief where no usufructuary right had been created;

Scheme: according to the AG, the fact that a Member State could, based on Article 3(2) of the Directive, replace the criterion of holding in capital by that of holding voting rights is an argument to consider that it is not necessary to hold voting rights in order to benefit from the Directive;

Wording: according to the AG, the context for interpretation of the Directive is not primarily a company law context and the fact that the Directive refers to *"a holding in the capital of another company"* (while the usufructuary has not contributed any capital) and to *"a parent company's association with its subsidiary"* (while the usufructuary has no genuine association with the company but is instead entitled to receive dividends by virtue of a contractual arrangement with the legal shareholder) does not exclude the usufructuary from the benefits of the Directive.

The AG concludes that the benefits of the Parent-subsidiary Directive (exemption of taxation in the Member State of residence of the beneficiary) should be granted in a situation where ownership of the shares in the subsidiary has been severed, so that dividends are received by one company by virtue of a right of usufruct while legal ownership remains with another company.

-- Olivier Hermand and Patrice Delacroix, Belgium; olivier.hermand@pwc.be

Germany – ECJ referral on withholding tax on outbound dividends: Gaz de France case (C-247/08)

On 23 May 2008, the Lower Finance Court of Cologne referred a new preliminary ruling to the ECJ concerning the taxation of outbound dividends.

In 1999, a German subsidiary (GmbH) distributed dividends to its French resident parent company, which had the legal form of a "société par actions simplifié" (SAS). Under German tax law, dividend payments are subject to withholding tax, unless the Parent-Subsidiary Directive (or a double tax treaty) is applicable. In 1999, the Parent-Subsidiary Directive was not applicable in such cases, because a company in the legal form of a SAS was not a company for the purposes of the Directive prior to 2005. Since 2005, SAS are covered by the Directive, too.

The Lower Finance Court asked whether the Parent-Subsidiary Directive (1) could be interpreted in the years prior to 2005, in such a way that SAS' are entitled although not explicitly mentioned; or (2) is in breach of the freedom of establishment as it favours only specific legal forms of French companies but not the SAS.

This referral is somewhat surprising. Since *Bosal Holding B.V.* (C-168/01) and *Keller Holding GmbH* (C-471/04) it is common knowledge that not only the provisions of a Directive are subject to a compatibility check but also its national implementation. This national implementation must be compatible with the fundamental freedoms. The proper question to the ECJ should have been whether the levying of German withholding tax infringes the free movement of capital or the freedom of establishment. That is because the withholding tax for non-resident shareholders is final, whereas in 1999, resident shareholders were entitled to an imputation credit. The imputation credit resulted in the dividend being economically tax-free. After the decisions of the ECJ in *Denkavit* (C-170/05, see EUDTG Newsalert NA 2006-035) and *Amurta* case (C-379/05, see EUDTG Newsalert NA 2007-038), it seems to be quite obvious that the compatibility of the final withholding tax burden with the fundamental freedoms depends on the double tax treaty between Germany and France and the actual possibility to impute the German withholding tax in France.

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Netherlands – ECJ referral on cross-border fiscal unity

On 11 July 2008, the Dutch Supreme Court (*Hoge Raad*) decided that the Dutch fiscal unity system may be contrary to EC Law. It has referred the case at issue to the ECJ.

The taxpayer (X Holding BV), a limited liability company incorporated and resident in the Netherlands, and its 100% subsidiary F NV, incorporated and resident in Belgium, requested for application of the Dutch fiscal unity regime. Under this form of group taxation, the results of the companies that form part of the unity are calculated on a fully consolidated basis, which (among others) implies that (i) losses of one company can be offset against profits of another company; (ii) intercompany transactions between fiscal unity companies are not visible for tax purposes; (iii) the fiscal unity companies file one corporate income tax return for the entire entity. This beneficial system is, however, limited to Netherlands resident companies or to non-resident companies that conduct business in the Netherlands through a permanent establishment. As a result of that, the request to consolidate X Holding BV's profits with the losses of F NV, was rejected. X Holding BV objected to this rejection arguing that the exclusion of non-resident companies infringes the freedom of establishment.

The *Hoge Raad* observed that the exclusion may be regarded as an impediment for resident companies to establish themselves in another Member State since, although it doubts whether the different treatment should not be regarded as inherent in the system of a fiscal unity and in conformity with the principle of fiscal territoriality. If the exclusion would indeed constitute a restriction of freedom of establishment, the Hoge Raad asks whether such a restriction may be justified on the grounds accepted in the *Marks & Spencer* judgment (Case C-446/03). According to the *Hoge Raad* it is not clear to what extent these grounds apply similarly in the context of the fiscal unity regime.

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NATIONAL DEVELOPMENTS

Austria – Administrative Hight Court decision on taxation of inbound portfolio dividends

According to the Austrian Corporate Income Tax (CIT) Act, dividends received by Austrian companies from foreign entities are treated tax neutrally under the international participation exemption, if the direct and indirect (e.g. through a subsidiary) investment amounts to at least 10 per cent of the foreign company's share capital (besides some other requirements).

However, dividends distributed by an Austrian company to its Austrian holding company are tax exempt at the level of the receiving company, irrespective of the amount of the participation. Therefore, foreign portfolio investments (i.e. less than 10%) are treated differently compared with domestic portfolio investments.

On 14 April 2008, the Austrian Administrative High Court decided (Decision 2008/15/0064) that this different treatment is contrary to Article 56 EC (free movement of capital principle) as foreign investments are discriminated against compared with domestic investments.

The Austrian Administrative High Court – in contrast to the national rule regarding the non-taxation of dividends – decided that not the exemption but the credit method should apply. The Court stated that EU law displaces national law only insofar as the latter is contrary to EC Law. The Court justified its approach by referring to several decisions of the ECJ where it was decided that EU Member States are free to apply the exemption method to dividends received from local companies and the credit method to foreign dividends, including: *Test Claimants in the FII Group Litigation* (C-446/04), *The Test Claimants in the CFC and Dividend Group Litigation* (C-201/05) and *Columbus Container* (C-298/05).

The Austrian Ministry of Finance issued a Decree on 13 June 2008, which states that in the future, Austrian holding companies have the possibility to credit foreign CIT which was levied on portfolio dividends under foreign legislation. In order to be able to achieve the tax credit, several filing requirements have to be considered (e.g. indication of the distributing company, the interest held, the foreign CIT rate, the amount of foreign CIT levied, etc.). In practice, the indication of the amount of CIT levied will probably cause administrative problems as this information can not usually be obtained from the financial statements of the distributing companies.

Furthermore, the Ministry limited the tax credit to portfolio dividends from companies resident in the EU and Norway (as an EEA member state with a comprehensive agreement on administrative and execution assistance with Austria). As the principle of free movement of capital according to Art 56 EC is applicable also to third countries, the Ministry's approach may be contrary to EC Law. The Ministry however considers the non-existence of a comprehensive agreement on administrative and execution assistance to be a justification for its discriminatory approach.

Up to now it is not clear whether foreign withholding taxes can also be credited against Austrian CIT as the High Court did not comment on this issue and some authors argue that the source state should solve the withholding tax issue. Based on the Decree of the Austrian Ministry of Finance it is also possible to credit (besides the foreign CIT paid by the dividend distributing company) foreign withholding tax within the limits of the double tax treaty.

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Finland – Amendment of the Finnish CFC legislation in order to meet the requirements of EC law

The Finnish Government has initiated a Bill (74/2008) to Parliament concerning the amendment of the Finnish CFC legislation with the main purpose of bringing the regime into compliance with EC law. In addition, the Bill proposes a few other amendments, the most significant being the treatment of foreign permanent establishments (PE) as CFCs in the same way as regular entities, if the exemption method is applied between the PE and its head office country. Notwithstanding the amendments, the basic structure of the Finnish CFC regime, e.g. the list of acceptable activities and acceptable establishment in tax treaty countries etc. is left intact. The amended CFC regime should enter into force on 1 January 2009. This article does not describe the full content of the Finnish CFC legislation, but rather focuses on a few separate issues in it.

According to the proposal, permanent establishments could be regarded as equal to foreign companies provided that the PE's profits are not taxed in the head office state, i.e. when the exemption method is applied. Accordingly, the applicability of the Finnish CFC regime to foreign PEs would be determined independently from the head office. Due to the transition period, the PE provision would be applicable to PEs of foreign entities existing on 31 December 2007 only as of 1 January 2015.

The proposed new CFC legislation would exclude from its scope of application entities resident in certain countries, if they are genuinely established in their residence state and actually carry out genuine economic activities there. Genuine establishment would be assessed by means of three objective criteria explicitly specified in the proposed new CFC legislation. Firstly, the foreign entity should have adequate premises and equipment available to it in its residence state for carrying out its business activities. Secondly, the entity should have sufficient and skilled personnel that would have the authority to carry out *de facto* the entity's business activities independently. Thirdly, the entity's personnel should have the authority to make independently decisions relating to the entity's day-to-day activities. The genuine establishment assessment is based on overall evaluation taking into consideration special features of each field of business activity and characteristics of the activities carried out. If the above requirements are not fulfilled, the establishment may be deemed to be a wholly artificial arrangement.

The above presented exception for genuine establishment would apply to foreign entities resident in the EEA states and, in addition, to states with which Finland has concluded a double tax treaty provided that there is an agreement on adequate exchange of information in tax matters between Finland and the state in question. Liechtenstein is therefore out of the scope of "genuine establishment" rule. Because of the lack of information exchange, the new CFC legislation would also be applicable to certain overseas territories of EU member states. A special feature, however, is that the "genuine establishment" rule is applicable to some (non-EU/EEA) tax treaty countries as well.

According to the current CFC legislation and the proposal, the Finnish CFC legislation is not applicable to certain companies resident in tax treaty countries where Finland considers the general level of corporate taxation sufficiently equivalent to the Finnish level. The CFC proposal includes the introduction of a binding "black-list" which contains a list of tax treaty countries without sufficiently equivalent corporate income taxation.

Another interesting feature of the Bill is the proposal to increase the threshold for qualifying participation in a CFC to 25%. Currently, Finnish CFC legislation may be applicable to a person having a 10% participation in a foreign company, provided that Finnish residents (whether affiliated or not) have control over the foreign company (at least 50% participation). The requirement for the new 25% threshold is to exclude the EC Treaty free movement of capital and to come within the scope of freedom of establishment only.

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Germany – Recent legislative developments regarding the treatment of losses from EU/EEA countries

In response to the European Commission's move to open an infringement procedure against Germany, there have been significant legislative initiatives in order to bring the treatment of losses according to Sec. 2a German Income Tax Act (ITA) in line with EC law requirements. While an Official Decree by the Federal Ministry of Finance has been issued to suspend adverse effects for the time being, Sec. 2a ITA is due to be amended at the end of this year.

In general, German residents are taxable on their worldwide income comprising both positive and negative income (i.e., losses). Due to Sec. 2a ITA, specific types of losses from so-called passive income generated abroad which are not tax exempt by double tax treaties can only be offset with positive income from the same category and the same state. As losses generated in Germany can be offset without any restriction, on 18 October 2007 the Commission took the view that the different deductibility of domestic and cross-border losses is incompatible with EC Law principles (see also EUDTG Newsalert NA 2007 - 035).

The tax administration has responded to the opening of the infringement procedure by issuing an Official Decree dated 30 July 2008 which suspends the applicability of Sec. 2a ITA as regards tax losses created in EU/EEA states. As a result, such foreign losses are deductible without restriction for the time being.

The Decree may also have effect on the determination of the progressive income tax rate in cases where income is tax exempt under the applicable double taxation treaty. Under German tax law, tax-free foreign income is generally taken into account for determining the progressive income tax rate. However, whereas positive income is always being taken into account, negative income may only be considered if not passive. This was contested in the *Ritter-Coulais* case (see also EUDTG Newsalert NA 2006 - 003). Although the Decree does not explicitly deal with this issue, it allows in principle considerating EU/EEA losses for the purpose of calculating the progressive income tax rate.

As an EC Law infringement may only effectively be remedied by a measure of the same quality by which it was brought about, Sec. 2a ITA will be materially changed by the Annual Tax Bill 2009 which is due to be enacted by the end of this year.

A draft which has been circulated recently provides for the taking into account of losses generated in EU/EEA states without restrictions. Third country losses, however, will remain subject to the restrictions described above. With respect to the determination of the income tax rate, the draft explicitly states that certain (positive or negative) income from another EU country will not affect the calculation of the progressive rate, including land and forestry income, business income from a passive permanent establishment, and property income. Tax exempt income from active permanent establishments will still have to be considered when determining the progressive tax rate.

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Germany – Case pending with the German Federal Constitutional Court regarding the denial of interest on refund of withholding tax

In 1997, a German resident agency ordered a music group for concerts in Germany from a UK resident agency. The gross amount of the payment from the German agency to the UK agency was subject to a withholding tax. In 1998, the UK agency applied for an offsetting of expenses connected with these concerts and claimed for a tax refund and interest. Almost three years later, the fiscal authority issued an assessment granting a refund, but denied any interest on it. According to the German tax law, tax refunds of withholding tax due to tax claims do not yield interest, whereas tax refunds due to an assessment do yield interest. However, most times non-residents do not have the choice between a claim or an assessment as they can only opt for a tax claim. Only residents could opt for an assessment.

A few months ago, the Federal Finance Court (BFH) argued that this denial was in accordance with the German Fiscal Code and EC Law. In the BFH´s view, the procedure of levying and refund of withholding tax as well as its consequences for the liquidity for non-residents were accepted by the ECJ in *Scorpio* (C-290/04). The non-resident had the possibility to claim a tax refund within a short time in order to avoid cash flow disadvantages. For the BFH, it was not conceivable to interpret a claim as an assessment. However, the BFH realises that this procedure may constitute an obstacle for non-residents and may therefore not be in line with the *effet utile* principle. Nevertheless, the BFH stated that such a disadvantage could only be claimed by an action to recover damages against the State. As the BFH has no doubts about the interpretation of the fundamental freedoms, it did not refer the case to the ECJ. Now, the case is pending with the German Federal Constitutional Court (BVerfG).

In our view, neither the quoted *Scorpio* case nor other ECJ cases indicate that a refund of withholding tax to non-residents does not need to yield interest. In contrast, in *Commerzbank* (C-330/91), the ECJ has confirmed an infringement when refunds to non-residents do not yield interest whereas refunds to residents do. Furthermore, to commence an action to recover damages against the State is the very last recourse open to a tax payer. Such an appeal is subject to very strict conditions and is even in domestic situations rather uncommon and rarely successful. The BFH should have referred the actual case to the ECJ. It remains to be seen whether the BVerfG will decide that the decision of the BFH is in breach of the German Constitution (deprivation of a lawful judgement and refer the case back to the BFH.

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Hungary – Film Incentive Scheme Amended

On 9 June 2008, the Hungarian Parliament approved amendments to the provisions of the Motion Picture Act and the Corporate Income Tax Act regarding tax allowances of film production in order to comply with EU regulations. The amendments entered into force on 2 July 2008.

A producer may significantly reduce his overall production costs by receiving financial support from Hungarian tax resident corporate sponsors of up to 20% of the direct production costs provided certain criteria are met. The new provisions will allow not only Hungarian direct costs to be taken into consideration – based on a special calculation method and as previously was the case, but all direct costs, including foreign costs in certain circumstances as well. The higher the amount of direct production costs incurred in Hungary, the higher the amount of foreign direct production costs that can be taken into consideration.

The sponsors providing the financial support can utilise both a tax incentive and a tax base allowance related to the support provided, resulting in an amount of tax saving up to 23.2% of the direct production costs if certain criteria are met.

In line with the new provisions, corporate income tax and tax base allowances can only be obtained in respect of “films produced on order” (service production – films produced in Hungary on the order of a foreign producer) and “films not produced on order” (co-productions – films produced in Hungary on the order of a Hungarian producer). The production should also fulfil the newly introduced “cultural test”.

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Netherlands – Dutch Supreme Court: Dutch withholding tax on dividends paid by a Dutch ‘dividend mixer company’ to a UK holding company restricts freedom of establishment

On 8 August 2008, the Dutch Supreme Court (*Hoge Raad*) handed down its judgment in Case No. 40 586. The case concerned a ‘dividend mixer company’, resident in the Netherlands, which distributed dividends to its 100% shareholder, a company resident in the UK. Apart from its Dutch subsidiary, the UK company also had a permanent establishment in the Netherlands, to which the shares in the subsidiary cannot be attributed under Dutch attribution rules. At the time of the distribution, the Parent-Subsidiary Directive was not yet in force, and the distribution of dividends by the Dutch subsidiary to its UK parent was subject to a withholding tax of 5%. The applicant argued that the withholding tax infringes the EC Treaty. Two comparisons were brought forward.

Firstly, the applicant argued that EC Law requires that the shares are attributed to the permanent establishment – in that situation no withholding tax would be due – because the shares would have been attributed to the Netherlands tax jurisdiction if the shares had been owned by a legal person resident in the Netherlands. According to the applicant, this different treatment restricts a free choice of legal form. The Supreme Court rejected this argument on grounds of objective differences between a legal person and a permanent establishment on the point of attribution of assets.

Secondly, the applicant argued that the Dutch withholding tax infringes Article 43 EC, because this tax would not have been levied if the UK parent company would have been a resident of the Netherlands. The Court agreed with the applicant referring to *Amurta* (C-379/05, see EUDTG Newsalert NA 2007-038) and *Denkavit* (C-170/05; EUDTG Newsalert NA 2006-035).

The Supreme Court left it to the lower court to determine whether the UK-Netherlands tax treaty enables the effects of the restriction on the free movement of capital to be neutralised. Interestingly, the Supreme Court held that the lower court should examine whether a tax credit was given in the UK on the basis of the tax treaty on the actual facts of the case. It tactically rejected the view that it should be examined *in abstracto* whether the Netherlands has made sure that the discriminatory effects of its system are neutralised in the tax treaty (which it did not, because the tax treaty does not provide for a full credit).

-- Sjoerd Douma and Jaap Pronk, The Netherlands, sjoerd.douma@nl.pwc.com

Romania – Romania amends fiscal code provisions affecting taxation of outbound dividends to companies resident in Liechtenstein, Iceland and Norway

On 24 June 2008, the Romanian Government issued an emergency Ordinance to amend the tax code. This Ordinance sets forth a series of amendments, one of which is a direct consequence of the letter of formal notice Romania received this spring from the European Commission regarding its alleged discriminatory taxation of outbound dividends paid to foreign companies (see: EU Tax News 2008 - 004).

The Commission's letter of formal notice referred to the following two issues:

1. Domestic dividends paid in relation to participations of up to 15% are subject to a final withholding tax of 10%. On similar outbound dividends, Romania levies a withholding tax of 16%, subject to treaty relief. As Romania has concluded tax treaties with all other EU Member States and Norway, the discrimination affects only residents of Iceland and Liechtenstein (EEA members to which free movement of capital applies and with which Romania does not have a tax treaty in force).

2. Domestic dividends paid in relation to participations of 15% or more are withholding tax exempt. In contrast, Romania levies a final withholding tax of 10% on similar outbound dividends paid to companies resident in Norway and of 16% on dividends paid to companies resident Liechtenstein and Iceland.

Thus, starting 1 January 2009, the following will apply:

The withholding tax rate applicable to non-qualifying dividends paid to companies resident in both EU and EEA member states will be reduced from 16% to 10%;
The zero withholding tax rate for qualifying dividends currently applicable to companies resident in other EU Member States will also apply to companies resident in the EEA.

Moreover, the Ordinance proactively introduces a reduced withholding tax rate of 10% (0% in 2011) on interest and royalties, for companies resident in an EEA member state. The provision is currently applicable only to companies resident in an EU Member State which fulfils certain qualifying conditions.

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Spain – Government submits Bill to parliament to comply with ECJ judgment on R&DT innovation tax credit scheme (Case C-248/06)

On 13 March 2008, the ECJ ruled that Spain has failed to fulfil its EC Treaty and EEA Agreement obligations with regard to the freedom of establishment and freedom to provide services by maintaining in force rules for R&D and Technological Innovation tax credits which are more onerous for R&D activities carried out outside of Spain. According to these rules, expenses incurred by R&D activities carried abroad are deductible only if the principal R&D is carried out in Spain and to the extent these expenses do not exceed 25% of the total amount of the R&D expenses, whereas the deductibility of expenses incurred by R&D activities carried out in Spain is not subject to limitations (see also: EU Tax News 2008 - 004).

As a result of the ECJ's judgment, the Spanish Government has submitted a Bill to the Spanish Parliament on 14 August in order to amend Article 35 of the Spanish corporate tax law such that the expenses incurred by R&D activities carried out in Spain, another EU Member State or a member state of the EEA will be deductible. If the Bill is adopted, the expenses incurred by R&D activities carried out outside of the EU or EEA will no longer be deductible at all, although the principal R&D activity is carried out in Spain and although they do not exceed 25% of the total incurred amount.

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UK – High Court decision in Vodafone 2 v Commissioners of HMRC

On 4 July 2008, the High Court issued its judgement in the case *Vodafone 2 v HMRC* in favour of Vodafone 2.

The judgement relates to an appeal brought by Vodafone 2 Limited against the decision of the Special Commissioners in July 2007 concerning the interpretation of the "motive test" (s748(3) ICTA 88) in the light of the ruling of the ECJ in *Cadbury Schweppes* (C-196/04)

Vodafone 2 is a UK company which holds 100% of the shares in a company incorporated in Luxembourg ("VIL"). VIL holds the shares of several of European operating companies of the Vodafone Group. In 2002, HMRC opened an enquiry into Vodafone 2's tax return for the year ended 31 March 2001 and asked for extensive information about VIL. HMRC was concerned that VIL was a CFC and therefore all of its profits for the year should be attributed to Vodafone 2 and taxed accordingly.

Vodafone 2 refused to answer the query, stating that the UK's CFC legislation was in breach of the EC Treaty in that it restricted Vodafone 2's freedom to establish a company in the Luxembourg. Accordingly, Vodafone 2 appealed to the Special Commissioners to have the enquiry closed. In the meantime, Cadbury Schweppes was also in the process of challenging UK CFC legislation on similar grounds. Cadbury had appealed to the Special Commissioners in 2000 which in turn referred questions on the matter to the ECJ.

In September 2006, the ECJ issued its ruling in *Cadbury Schweppes*. The ECJ held that the UK's CFC legislation was in breach of the EC Treaty in that it restricted the right of UK companies to establish themselves in other Member States. However, the CFC legislation was nonetheless justified and proportionate if, and only if, it applied exclusively to "wholly artificial arrangements". The ECJ left it up to the UK courts to decide whether or not the "motive test" could be interpreted as applying exclusively to "wholly artificial arrangements".

In July 2007, the Special Commissioners reconvened a hearing of the *Vodafone 2* case to consider this question. In particular, the Specials considered whether the exclusive application of the "motive test" to "wholly artificial arrangements" could be "read down" into the wording of s748(3) - thus affording an interpretation to the CFC rules that was compliant with the EC Treaty - or in the alternative, should the entire CFC legislation be "disapplied" because the "motive test" could not be construed as such. The Specials decided (by way of the Chairman's casting vote) that the "motive test" is capable of being "read down" and was therefore not contrary to the EC Treaty.

Vodafone 2 appealed the decision to the High Court, which allowed Vodafone 2's appeal. Having exhaustively reviewed the case law on the interpretation of domestic law in the context of EC Law, the High Court presided over by Evans-Lombe J held that:

"*73. ...it is impossible to construe Section 748(3) of ICTA* [i.e. the motive test] *so as make it conform with the right of freedom of establishment under Article 43* [EC]."

and further:

"*90. In my judgment the CFC legislation, which depends on Section 747 and Section 748 for its effectiveness, must be disapplied so that, pending such amending legislation or executive action, no charge can be imposed on a company such as Vodafone under the CFC legislation*."

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EU DEVELOPMENTS

European Commission formally requests Germany to apply the ECJ "Volkswagen" judgment ("golden shares"; C-112/05)

On 23 October 2007, the ECJ ruled that certain provisions in the so called "Volkswagen" Act infringe the free movement of capital. The provisions in question provide for a mandatory representation of public authorities (the Federal Government and Lower Saxony) on the Volkswagen supervisory board (as long as they hold shares in the company) and a 20 % voting cap in combination with a 20 % blocking minority. Thus, a majority of more than 80 % of the shares is required in order to pass certain resolutions. The result is that the Volkswagen Act grants special powers to any shareholder having just 20 % of the voting rights (at the time of the ECJ judgment, this applied to Lower Saxony). This derogates from general law, which does not provide for a voting cap and also provides for a voting majority of 75 % rather than 80 %.

In its judgment, the ECJ held that these provisions limit the possibility for other shareholders to participate in the company with a view to establishing or maintaining lasting and direct economic links with it which would make possible participation or control in the management of that company. As a result, such provisions are liable to deter investors from other Member

States from acquiring a stake in the capital of that company and thus constitute a restriction on the free movement of capital.

So far, the Commission has not received any information that indicates that specific measures will be taken by the German Government to effectively comply with the Volkswagen judgment of the ECJ. The Commission consequently takes the view that Germany has failed to fulfil its obligations under the EC Treaty and has therefore decided to open infringement proceedings against Germany.

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CCCTB - common consolidated corporate tax base

European Commission's proposal for CCCTB delayed

In his key note address to the International Fiscal Association (IFA)'s annual congress, which was held in Brussels from 31 August – 5 September 2008, EU Tax Commissioner Kovács confirmed rumours that the draft legislative proposal for a Directive on the Common Consolidated Corporate Tax Base (CCCTB) will be delayed. The Commission needs to do a lot more work especially in some very detailed technical areas, in particular those related to the financial sector, before it can table a proposal, according to the Commissioner. Mr Kovács added that he "would rather present a perfectly elaborated and well justified product at the appropriate time than present an incomplete one just to meet an artificial deadline." The draft proposal was due to be presented to the College of Commissioners this autumn after which it would be formally proposed to Council. Mr Kovács did not provide any clues in his speech as to a new possible deadline for the draft proposal.

The official reasons for the delay cited by the Commission are purely of a technical nature. Whilst that is certainly partly true, it can however be argued that even if the proposal had been completed on time, it was becoming more and more unlikely from the beginning of 2008 that the Commission would be able to table its plans for a CCCTB Directive after the summer for a number of political reasons.

For one, the Irish "No" vote in June on the EU's Lisbon agreement -aimed at modernising and streamlining the EU institutionally- and the ensuing political legitimacy crisis at European level, has badly affected the original CCCTB timetable of the Commission. It has meant that the little political momentum that was still left for as contentious an issue as the CCCTB has proved to be, evaporated. The Commission will not want to take any risks with a view to a possible second referendum in Ireland in the coming months. The Irish remain deeply suspicious of the CCCTB and flatly oppose it, as do a handful of other Member States.

Secondly, the apparent waning of the strong initial political support for the CCCTB from the German and also the French government in the last six months has certainly not helped the Commission either.

Thirdly, adding further to this complicated political equation is the fact that Commission President Barroso has indicated that he wants to run for another five years in office. He will try to muster as much support as he possibly can for his re-election bid from national capitals in the run-up to next year's election. This, and the fact that this is the last year of the five-year mandate of the current Commission, might mean that politically sensitive dossiers are being delayed or left for the incoming Commission which will come to power in November 2009. Last but not least, as the economic downturn is being felt more and more in Europe, this is hardly an ideal timing for the launch of such a controversial and far-reaching experiment which directly affects the sovereign taxing powers of the EU's Member States.

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STATE AID

Italy – Enactment of law for the recovery of unlawful State aid granted to certain banks for the tax recognition of their hidden capital gains

By means of the Decree Law of 25 June 2008, No. 112 (converted into Law on 6 August 2008, No. 133), Italy took the first law measures to comply with the European Commission's decision of 11 March 2008 which ordered the recovery of the 2003 State aid granted to certain Italian banks.(see also: EU Tax News 2008 - 004). The State aid in question concerned the 2003 tax scheme which allowed formerly State-owned banks a favourable tax recognition of the capital gains arising from their privatisation during the 1990s.

The 2003 tax scheme provided that such capital gains could be released by paying a substitute tax (in lieu of the 37.25% ordinary corporate income taxes) equal to:

- 12% of the same capital gains in the case of realignment of the book and the tax value of both the assets held by the banks and the stocks received, as a consequence of the privatisation of the banks, by the banking holdings (i.e. non-profit entities so-called "banking foundations"); or

- 9% of the capital gains in the case of realignment only of the book and the tax value of the assets held by the banks.

In order to comply with the Commission's decision, the Italian Parliament enacted the following law provisions laid down in the abovementioned Decree Law:

- the beneficiaries of the State aid have to pay the difference between the substitute tax actually paid and the substitute taxes they would have paid in the case of application of the tax revaluation scheme, provided for by section 2(25) of the same Bill Law for 2004, which could be applied by all taxable companies (19% substitute tax in the case of realignment of the book and the tax value of depreciable assets or 15% substitute tax in the case of realignment of the book and the tax value of non-depreciable assets);

- within 30 days from the entry into force of Law No. 133, the Italian Tax Authorities will approve a specific form which will have to be filled in by the beneficiaries in order to self-assess the amounts to be paid. Then the beneficiaries will have to file the form with the Italian Tax Authorities within 15 days from its issuing;

- after receiving the forms, the Italian Tax Authorities will check the amounts due, interest included, and then will notify to the involved banks the amounts to be paid.

If the banks involved do not pay, the amounts due will have to be recovered by the Italian Tax Authorities by means of other legal instruments provided for by the Italian law.

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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 EC 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.

For further information regarding the contents of this newsletter or the EUDTG in general, please contact the EUDTG Secretariat through Bob van der Made (email: bob.van.der.made@nl.pwc.com; or tel.: + 31 10 407 5688).

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