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On 4 December 2008, the ECJ ruled that it is contrary to the freedom to provide services to refuse an investment growth premium to a lessor to the extent the lessee uses the leased assert in other Member States of the EU.

To stimulate the Austrian economy, under certain conditions an investment growth premium of 10% was granted to Austrian taxpayers for the years 2002 to 2004. According to Austrian tax law, the investment growth premium could only be claimed for investments in assets which were predominantly used in Austrian businesses.

In 2003, Jobra Vermögensverwaltungs-Gesellschaft mbH ("Jobra"), a company incorporated under Austrian law, applied for the investment growth premium in connection with the acquisition of lorries. Jobra, which operated an investment management business, leased the lorries to its 100% Austrian subsidiary, an international transport company. The responsible Austrian tax office, at first, granted the investment growth premium, however, in the course of a tax audit, it claimed the repayment of the investment growth premium since these lorries were used by Jobra's subsidiary primarily abroad. Jobra appealed against that decision on the ground that the requirement that only assets deployed predominantly in Austrian businesses qualified for the investment growth premium conflicted with the freedom of establishment (Article 43 EC) and the freedom to provide services (Article 49 EC). The Austrian Fiscal Court ("Unabhängiger Finanzsenat") referred the issue to the ECJ on 3 July 2007.

In its judgment the ECJ argued that the refusal of the investment growth premium to a lessor on the assumption that the lessee might use the leased assets in other Member States of the EC is a breach of Art 49 EC. The Austrian provision is likely to discourage the lessor from providing rental services to operators that carry out their activities in other Member States as well as the lessee from doing cross-border business.

The Austrian provision could not be justified by the necessity to safeguard the coherence of the national tax system since there was no direct link between the investment growth premium claimed by the taxpayer and the taxation of the income generated through the use of the hired assets in the hands of of the lessee. Concerning the claimed justification based on the need to prevent abuse, the ECJ emphasised that a national measure restricting a fundamental freedom guaranteed by the EC Treaty can only be justified where it specifically targets wholly artificial arrangements which do not reflect economic reality and whose only purpose is to obtain a tax advantage. Apart from the fact that the given business model could not be qualified as an abusive arrangement, the Austrian legislation at issue does not limit the refusal of the investment growth premium to artificial and abusive arrangements only.

-- Rudolf Krickl and Richard Jerabek, Austria; friedrich.roedler@at.pwc.com

Belgium – ECJ judgment on Belgian taxation of interest payments: Truck Center case (C-282/07)

On 22 December 2008, the ECJ ruled that the Belgian taxation system of interest payments i.e. taxation of interest payments towards non-resident companies by withholding versus. taxation of interest payments towards Belgian resident companies by assessment, is compatible with the freedom of establishment (Article 43 EC).

The Belgian tax legislation provides for a withholding tax on Belgian sourced interest paid to non-Belgian resident companies (not having a Belgian permanent establishment). The withholding tax suffered constitutes the final tax for the foreign companies. A withholding tax exemption, however, applies to Belgian sourced interest paid to Belgian resident companies. In this situation, the interest income is only subject to Belgian corporate income tax in the hands of the Belgian company that receives the interest payment. The latter is taxed through its assessment notice after the income tax return is filed.

According to the ECJ, the freedom of establishment and the free movement of capital (Article 56 EC) do not preclude a national withholding tax on interest payments to non-resident companies, while exempting from that withholding tax interest payments to resident companies.. As such, the ECJ judgment follows AG Kokott's Opinion of 18 September 2008. (See also EUDTG Newsalert NA 2008-019).

The ECJ judgement is mainly based on the two following arguments:

First, the situations of resident and non-resident companies are not objectively comparable. On the one hand, when both the company paying the interest and the company receiving that interest are Belgian residents, the Belgian State acts in its capacity as the State of residence. On the other hand, in case the interest is paid to a non-resident, the Belgian State acts in its capacity as source State. The payment of interest by a resident company to another resident company and the payment of interest by a resident company to a non-resident company give rise to two distinct charges (i.e. corporate income tax and withholding tax) based on two separate legal bases. In addition, the Belgian State has much less recovery power on non-residents than on Belgian residents.

Secondly, the difference in treatment resulting from the Belgian tax legislation does not necessarily produce an advantage for resident recipient companies. The Belgian recipient company is obliged to make advance payments of corporate income tax and the amount of withholding tax deducted from the interest paid to a non-resident company is significantly lower than the corporate income tax charged on the income of the resident companies which receive interest.

The ECJ concluded that the withholding tax on interest payments to non-resident companies does not constitute a restriction of the freedom of establishment. The fact that interest payments to resident companies are exempt from this taxation does not alter this conclusion, since these companies are subject to (1) the supervision of the Belgium tax authorities and (2) the Belgium corporation tax.

-- Olivier Hermand, Patrice Delacroix and Stijn Vanoppen and Mathieu Protin, Belgium; olivier.hermand@pwc.be

Belgium – ECJ judgment on applicability of Parent-Subsidiary Directive to shares in usufruct: Les Vergers du Vieux Tauves case (C-48/07)

On 22 December 2008, the ECJ ruled that the Parent Subsidiary Directive (90/435 EEC) does not in its own right apply to the holding of shares in usufruct. However, if a Member State would exempt dividends received from a resident company in relation to such usufruct, the same treatment should apply to dividends received from a company established in another Member State.

The case concerns a Belgian company holding the right of usufruct over shares in a Belgian company, while the legal ownership has remained with another Belgian company. The company holding the usufruct wanted to have the dividends received exempt from corporate income tax (via the Belgian "dividend received deduction" or DRD system). In its request for a preliminary ruling, the Court of Appeal of Liège asked the ECJ whether the concept of a "holding in the capital of a company of another Member State" in Article 3 of the Parent-Subsidiary Directive also includes the "holding of shares in usufruct".

In its judgement, the ECJ follows two principles.

First, the wording and the purpose of the Directive do not allow interpreting the concept of "a holding in the capital" within the Directive as covering the "holding in usufruct of shares",: The concept "holding in the capital" refers to a legal relationship between a parent and a subsidiary only. No such relationship exists between the usufructuary and the subsidiary. As the Directive only covers the situation of a parent company receiving distributed profits "by virtue of its association with the subsidiary", the usufructuary should not be covered given the fact that his right to dividends solely arises by virtue of a contractual arrangement with the owner of the shares. Article 4.2 of the Directive, holding that Member States "retain the option of providing that any losses resulting from the distribution of the profits of the subsidiary may not be deducted from the taxable profits of the parent company" clearly regards parent and subsidiary as being "one single company", which is not the case for the usufructuary and the distributing subsidiary.

Secondly, if a Member State would exempt dividends received from a resident company in relation to a holding of shares in usufruct, the same treatment should apply to dividends received from a company established in another Member State in respect of such usufruct. Even though the case at hand concerns a purely internal situation, the ECJ made it clear that EC Law requires, with respect to cross-border situations, that a Member State always respects the fundamental freedoms and should correspondingly apply the same tax treatment to dividends received from both resident and non-resident companies.

-- Olivier Hermand, Patrice Delacroix and Stijn Vanoppen and Mathieu Protin, Belgium; olivier.hermand@pwc.be

Finland – AG opinion on Finnish withholding tax on dividends to a Luxembourg SICAV: Aberdeen case (C-303/07)

On 18 December 2008, AG Mazák, held that the Finnish rules on withholding tax on dividends paid to a Luxembourg SICAV in a situation where the same dividend would have been tax exempt to a Finnish resident limited liability company or investment fund, are incompatible with the freedom of establishment (Article 43 EC and Article 48 EC). The AG concluded that a Finnish parent entity and a foreign parent entity are in an objectively comparable situation since both entities are subject to income tax in Finland. The exemption in purely intra-Finnish situations has as its purpose to eliminate (economic) double taxation. From ECJ case law it follows that in such circumstances the exemption should also apply to parent companies established in other EU Member States. .

The case concerns a Finnish resident limited liability company which distributed dividends to its parent SICAV company in Luxembourg. The Luxembourg SICAV in question was not an investment/common fund in the meaning of the UCITS Directive. As the Finnish dividend distributing company was not publicly quoted, intra-Finnish dividend paid to a Finnish limited liability company or to a Finnish investment fund would have been fully tax exempt. Therefore, as the SICAV is comparable to these Finnish entities it cannot be discriminated against. AG Mazák stated that the SICAV is discriminated against despite the difference in juridical form or the fact that it is income tax exempt.

In the case at hand, intra-Finnish dividends would have been tax exempt regardless of whether the Finnish recipient would have been a limited liability company or an investment fund. If the Finnish distributing company would have been a publicly quoted company, intra-Finnish dividends to a non-quoted limited liability company would have been taxed, but intra-Finnish dividends to an investment fund (which can be an investment fund/common fund in the meaning of the UCITS Directive) would have been tax exempt. As the majority of the investments by foreign investment funds – which in most cases have the legal form of a SICAV - are in publicly quoted companies, determining the right comparable Finnish entity becomes relevant. Unfortunately, the AG does not provide clear guidance on how to determine the correct comparable Finnish entity. This question did not become relevant with respect to the facts in the *Aberdeen-case*.

-- Martti Virolainen and Jarno Laaksonen, Finland; jarno.laaksonen@fi.pwc.com

France – ECJ judgment on French tax group regime: Papillon case (C-418/07)

On 27 November 2008, the ECJ handed down its decision in the Papillon case. The case deals with a provision in the French Tax Code, which states that a French parent company may not include in its tax group a French lower-tier subsidiary held indirectly by a subsidiary established in another EU Member State, whereas it may include in its tax group a lower-tier subsidiary held by a subsidiary established in France. The question was whether this provision constitutes a restriction of the freedom of establishment (Article 43 EC). The ECJ decided that such a restriction is not compatible with the freedom of establishment.

The French Government put forward two arguments to justify the restriction: the need to ensure a balanced allocation of taxing powers between the Member States, and the coherence of the French tax system.

The first justification was rejected by the ECJ because Papillon did not request any cross-border tax consolidation. Regarding the second justification, the ECJ acknowledged that the neutralisation of intra-group operations falls under the coherence of the French tax group regime. A double use of the same losses would consequently affect the coherence. This may occur when a lower-tier French subsidiary suffers a loss which is taken into account in France within the tax group, and also through the write down of shares held by the French parent in the EU intermediate company (caused by the write down of shares in the French lower tier entity). The ECJ recognised the need to ensure the coherence of the tax system provided that the proportionality test could be met.

The ECJ ruled that there are alternative and less restrictive measures which can be adopted by France to avoid a double deduction of losses. Not only could France ask the French parent to justify the rationale and origin of the write down of shares in the intermediate EU entity to avoid a double deduction of the same losses, it could also invoke the Mutual Assistance Directive (77/799/CEE) to obtain financial and accounting information concerning the intermediate EU entity.(See also EUDTG Newsalert NA 2008-017).

-- Jacques Taquet, Nicolas Jacquot and Emmanuel Raingeard, France; jacques.taquet@fr.landwellglobal.com

Germany – ECJ judgment on the valuation of shares in the case of a share exchange: A.T. case (C-285/07)

On 11 December 2008, the ECJ concluded that Art. 8(1) and (2) of Directive 90/434/EEC (Merger Directive) precludes national legislation under which a capital gain is taxed upon the cross-border exchange of shares between a transferring shareholder and an acquiring company unless the acquiring company carries over the historical book value of the shares transferred. The ECJ thus follows the AG's opinion in this case.

A.T., a German corporation, transferred 89,5% of shares in a German GmbH to a French company in exchange for shares in the French company. A.T. sought to value the shares received in the French company at the book value of the GmbH shares. The tax authorities denied this as the Reorganisation Tax Act (RTA) at the time allowed a carryover of the book value to the received shares only if the transferred shares were assessed at book value at the level of the acquiring company (so called double book value carryover). As the French company had chosen to attribute the fair market value, A.T. was required to assess the received shares at fair market value, which led to taxable profits at the level of A.T.

According to the ECJ, Art. 8(1) of the Merger Directive establishes the principle of unconditional tax neutrality for the exchange of shares in companies in different Member States. The ECJ held that the Directive does not provide a Member State with discretion, which Germany had argued for, on how to implement the principle of tax-neutrality. Any discretion would counter the objective of the Directive which is to set up a common tax system for cross-border restructurings, e.g. not to tax until the actual disposal. A Member State may thus not decide on additional requirements for tax-neutrality.

The ECJ dismissed the argument that the mechanism of the double book value carryover in effect guarantees the eventual taxation of capital gains. Inasmuch as the German Government had argued that such a rule is necessary to prevent the circumvention of taxation after the transfer of shares, the ECJ stated that tax benefits may only be withdrawn in exceptional cases after considering all facts of the individual case. A general rule such as the provision in the German RTA would, however, be contrary to the Merger Directive.

The fact that the market value of the shares in the French company had substantially decreased at the time of the actual disposal would, according to the ECJ, not justify taxation at the time of the exchange of shares as a realisation event had not occurred. The ECJ also questions Germany's interest in a rule which requires attributing the historical book value at the level of the acquiring company since such rule would only favour French revenue. Germany's interest would be even more questionable as the German rule at issue had been abolished in 2006.

The ECJ thus found the German provision to be contrary to Articles 8(1) and 8(2) of the Merger Directive.

-- Raimund Behnes and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Germany – ECJ referral on German tax allowance for donations between non-residents of immovable property situated in Germany

The claimant, a German national resident in the Netherlands for over 35 years, gratuitously received real estate located in Düsseldorf from her mother, a German national, who had been living in the Netherlands for more than 50 years.

As the donation was subject to German gift tax due to the location of the real estate, the tax office granted the claimant a tax allowance in the amount of EUR 1,100 as applicable for non-residents. The claimant, however, asked for the tax allowance applicable to residents in the amount of EUR 205,000, which the tax office rejected with reference to the German gift tax legislation.

Upon appeal, the Fiscal Court of Düsseldorf has issued doubts whether the different treatment of non-residents and residents for the purpose of granting a tax allowance complies with the free movement of capital (Article 56 EC). Referring to the recent cases C-11/07 (*Eckelkamp*) and C-43/07 (*Arens-Sikken*), the court considers that donations fall within the scope of the free movement of capital. It also considers the fact that the amount of tax allowance depends on the residence status of the donor to constitute an infringement of that freedom. Given that the tax base of the German gift tax is solely determined by the value of the real estate, such infringement may not be justified as resident and non-resident are in an objectively comparable situation. The Fiscal Court thus asked the ECJ for a preliminary ruling.

-- Raimund Behnes and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Hungary – ECJ judgment on whether a company registered in an EU Member State can transfer its operational headquarters to another Member State without restrictions: Cartesio case (C-210/06)

On 16 December 2008, the ECJ ruled that national rules or practices which prevent a company from transferring its seat to another EU Member State are compatible with the freedom of establishment (Article 43 EC and Article 48 EC).

Cartesio is a limited partnership in Hungary that asked the Court of Registry to register in the Company Registry the transfer of its operational headquarters from Hungary to Italy in November 2005. Cartesio wanted to remain incorporated in Hungary and therefore subject to Hungarian Company Law without being dissolved. The Court of Registry rejected the request. Cartesio brought an appeal against this decision before the Hungarian Szeged (court of appeal) which referred preliminary questions to the ECJ.

According to the ECJ, companies must be seen as creatures of national law and exist only by virtue of the national legislation which determines their incorporation and functioning. Under Hungarian Law, a company incorporated in Hungary may not transfer its seat, as defined by that Law, to another Member State while continuing to be subject to Hungarian Law governing its articles of association.

A Member State may define the kind of connection required to be incorporated, and on the grounds of it, it can decide to grant the right of establishment or not and whether the company can maintain that status. The Member State may also reject retaining that status if the company is wishing to reorganise itself by moving its seat to another Member State.

The ECJ states that there are two different situations which may nonetheless be EC Treaty protected. One is where the seat of a company incorporated under the law of one Member State is transferred to another Member State with no change as regards the governing law. The other one is where a company governed by the law of one Member State moves to another Member State with a change in the governing law. The ECJ states that the legislation of the various Member States has not addressed as yet, or has not eliminated yet the difference between the two above-described situations. Only for some specific legal entities created under EC Law (EEIG, SE or SCE) has the lack of EU harmonising legislation been removed by the respective EU rules. (See also EUDTG Newsalert NA 2008-018)

-- Gabriella Erdős, Hungary; gabriella.erdos@hu.pwc.com

Italy – AG opinion on the Italian “golden shares” rules: Commission vs. Italy case (C-326/07)

On 6 November 2008, in relation to the infringement procedure by the European Commission against Italy, and after the Volkswagen case (C-112/05), AG Colomer published his Opinion on whether the Italian “golden shares” rules comply with Article 43 EC (freedom of establishment) and Article 56 EC (free movement of capital).

Italian "golden shares" rules were first introduced in Italy by the Law Decree no. 332 of 1994 but they were held to to be in compliance with the EC Treaty by the ECJ (case C-58/99). Italy, by Law no. 350 of 2004, amended the previous legislation in order to make the Italian "golden shares" rules compatible with the EC Treaty. However, the Commission held that the specific measures, introduced in 2004, which aimed to avoid the acquisition by non-EU investors of major shareholdings in companies operating in strategic sectors, were still contrary to EU legislation and therefore a Reasoned Opinion was delivered to Italy on this matter. As Italy did not comply with the opinion, the Commission decided to refer the matter to the ECJ.

The Italian legislation in force grants special powers to the Italian Economics and Finance Ministry when it controls companies operating in defence, transport, communication, energy and other public sectors. In particular, the Ministry has:

- the opposition right regarding acquisitions by investors of shareholdings representing at least 5% (or a lower percentage fixed by ministerial decree) of the voting rights in companies operating in these sectors;
- the opposition right regarding the agreements between shareholders having at least 5% of the voting rights (or a lower percentage fixed by ministerial decree) in companies operating in these sectors;
- the veto right on the resolutions concerning the winding up, the sale of a going concern, the merger, the division, the movement of the registered office, the changing of the business purpose or corporate by-laws, relevant to the above-mentioned companies when there is a decision to eliminate or modify the special powers; and
- the right to appoint a director without voting power.

By Decree of 10 June 2004, the Italian Government established that the special powers mentioned under the first three bullets above could be exercised if specific circumstances are verified, such as the potential interruption of the supply of energy or other public services.

The AG considered that the provisions establishing the "special powers" mentioned under the first two bullets are in breach of Art 56 EC and that the veto power under bullet 3 breaches Article 43 EC. The AG also opined that these provisions cannot be justified as they are disproportionate in relation to the aim pursued by the Italian legislation on "golden shares". The AG advised the ECJ to include in its decision that the Italian provisions establishing the "special powers" mentioned under the first three bullets are incompatible with EC Law.

-- Claudio Valz, Italy; claudio.valz@it.pwc.com

Portugal – ECJ referral on Portuguese taxation of dividends paid to foreign pension funds

The Commission sent Portugal a letter of formal notice on 7 May 2007 regarding its discriminatory treatment of foreign pension funds, and has subsequently sent to Portugal a reasoned opinion on 6 May 2008. Since Portugal did not reply satisfactorily to the Commission nor has amended its discriminatory legislation, the Commission has now referred Portugal to the ECJ.

According to the Portuguese Tax Benefits Code ("Estatuto de Benefícios Fiscais"), Article 16 (1), any income obtained by pension funds established in Portugal and operating under the Portuguese rules is exempt from Portuguese Corporate Income Tax (CIT), meaning that any domestic dividends and/or interest paid to the pension fund are effectively tax free.

In contrast, payments of dividends and/or interest to pension funds established elsewhere in the EU or the EEA/EFTA are subject to withholding tax in Portugal at a rate of 20% as stated in Article 80 (2) (c) of the Portuguese CIT Code. The withholding tax foreseen in the Portuguese law may be reduced under the provisions of the double tax treaties concluded between Portugal and other Member States.

In the view of the Commission, the higher taxation on dividend and/or interest paid to foreign pension funds may dissuade these funds from investing in Portugal. The Commission also argues that companies established in Portugal may face difficulties in attracting investment and capital from foreign pension funds due to this difference in treatment.

The Commission considers that this situation results in a difference in treatment that poses a restriction to the free movement of capital as protected by Art 56 of the EC Treaty and Art 40 of the EEA Agreement.

At the same time, the Commission states that this discriminatory treatment may also result in a restriction of the freedom of establishment, protected by Article 43 EC and Article 34 EEA, in the case of controlling participations held by foreign pension funds.

The Commission's case reference number is 2006/4104.

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

Spain – ECJ referral on Spanish taxation of dividends paid to foreign pension funds

On 27 November 2008, the European Commission announced that it has referred Spain to the ECJ as it considers the Spanish legislation applicable to pension funds to be contrary to the EC Treaty and the EEA Agreement. The step now taken against Spain follows a Formal Notice and a Reasoned Opinion sent to Spain by the Commission in May 2007 and May 2008, respectively, as part of the EU's 3-stage infringement procedure (Art 226 EC). See also EUDTG Newsalert NA 2007 – 015).

Spanish pension funds are exempt from Corporate Income Tax on their income and may claim back any Spanish withholding tax on dividends received. Therefore, domestic dividends received by domestic pension funds are effectively tax free. By contrast, dividends paid to foreign pension funds (from the EU or EEA/EFTA) are subject to a 18% withholding tax. This means that even if bilateral tax treaties may lead to a lower withholding tax, it results in a higher taxation of dividends paid to foreign pension funds when compared to Spanish residents.

The European Commission is of the opinion that this situation is contrary to the EC Treaty and to the EEA Agreement since it results in an infringement of the free movement of capital and it may also result in an infringement of the freedom of establishment in the case of controlling participations held by foreign pension funds (articles 56 and 43 EC and articles 40 and 34 EEA respectively).

The Commission's case reference number is 2006/4106.

-- Ramón Mullerat, José Blasi and Rui Dinis Nascimento, Spain;
jose.blasi@es.landwellglobal.com

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NATIONAL DEVELOPMENTS

Czech Republic – Abolition of discriminatory taxation of foreign pension funds

In June 2008, the European Commission formally requested the Czech Republic by means of a Reasoned Opinion to amend its rules under which dividends paid to foreign pension funds are taxed more heavily than those paid to domestic pension funds (see also EUDTG Tax News 2008 – nr. 004).

In December 2008, the Czech Government approved changes to the Czech Corporate Income Taxes Act regarding the taxation of foreign pension funds established in other EU Member States, Norway and Iceland. Foreign pension funds from these countries have become exempt from corporate income tax on dividends and interest on bonds and various other securities. The standard corporate income tax rate of foreign pension funds in the Czech Republic was dropped to 5% (as opposed to 21% until 2008). The amended Corporate Income Taxes Act came into effect on 1 January 2009. The amendments cover Czech source income that is not subject to withholding tax and is not tax exempt (for example any income from the Czech real estate owned by a foreign pension fund once the direct holding arises).

The amendments to the Corporate Income Taxes Act may be used as an argument by foreign pension funds that withholding tax withheld in the past (from 1 May 2004) on interest and dividends paid to them should be refunded (within a three-year refund period).

-- Zenon Folwarczny and Tomas Racek; Czech Republic; zenon.folwarczny@cz.pwc.com

Germany – Federal Finance Court confirms the application of the free movement of capital for majority shareholdings in Third State resident companies

According to the German Corporate Income Tax Act (CITA), dividends from a domestic or a foreign company are basically tax exempt. Under the former law (2001/2002), 5% of foreign dividends were deemed non-deductible expenses. By contrast, expenses linked to domestic dividends were only non-deductible to the extent that they actually arose. Foreign dividends were treated unfavourably. In the case of a majority or minority shareholding in an EU resident company, the breach of the freedom of establishment (Article 43 EC) or the free movement of capital (Article 56 EC) was obvious and therefore the provision was inapplicable.

In a recent case concerning dividends from a majority shareholding in a Third State resident company, the Federal Finance Court confirmed its opinion that the free movement of capital should be applicable with the effect that the provision was inapplicable, too. In an oral hearing, the Court stated that the applicability of a Treaty freedom only depends on the scope of the provision and not on the actual facts of the case. As the provision at stake required neither a majority shareholding nor an affiliated group of companies, the free movement of capital should be applicable. Moreover, the Court stated that the potential applicability of the freedom of establishment would not exclude the applicability of the free movement of capital at the same time. The Court rejected any contradicting conclusions that could be drawn from the decision in the *Burda* case (C-284/06) or the order in the *SEW* case (C-415/06) of the ECJ. The written decision of the Federal Finance Court has not been published yet.

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

Hungary – Amendments to tax and accounting laws effective from 1 January 2009

The Hungarian parliament approved amendments to the tax and accounting laws which became effective on 1 January 2009. In most cases, the changes will not affect companies' income tax base or the tax burden in general, as they focus mainly on the rules of taxation and personal income tax.

The rules which have made Hungary an attractive financing and holding structure jurisdiction remain unchanged. These include the 50% deduction of royalty income and related-party net interest; the withholding tax exemption on interest, royalties and dividends paid, as well as the tax exemption on dividends received and on gains realized on the sale of registered shareholdings.

The good news for holding structures is that from 1 January 2009, Hungarian parent companies will no longer have to prepare consolidated annual and business reports according to the Hungarian GAAP, if their parent company ("superior parent company") is registered outside the EEA (e.g. in the USA), as they formerly had to, provided that the superior parent company prepares a consolidated annual report and business report according to standards equivalent to the IFRS (e.g. US GAAP, Canadian GAAP, Japanese GAAP).

The parliament has also eased the rules on foreign currency bookkeeping, which will provide further administrative relief. In 2008, companies could only keep their books in a foreign currency if at least 75% of their income, expenses and costs, and also their financial assets and liabilities, were denominated in that foreign currency. This threshold has now been reduced to 50% and will be further reduced to 25% in 2010. Additionally, starting from 2009 companies can choose to keep their books in Euro, if the foreign currency that meets the above threshold is not the Euro.

Furthermore, as a result of the implementation of a new regulation, if a company transfers its Hungarian registered office abroad, it has to file tax returns for any periods not yet reported, within 30 days of the move.

-- Gabriella Erdős, Hungary; gabriella.erdos@hu.pwc.com

Italy – Extension of tax neutrality granted to domestic mergers to mergers between foreign companies not covered by the EU Merger Directive

By means of Resolution Nr. 470/E of 3 December 2008, Italy has extended the tax neutrality regime granted to domestic mergers (i.e. mergers between companies which are both resident for tax purposes in Italy) to mergers between foreign companies not covered by the EU Merger Directive.

The Resolution deals with a merger by incorporation of a bank, which has a permanent establishment (PE) located in Italy, into another bank, both resident for tax purposes in Germany. More precisely, all the assets and liabilities of the merged bank will be transferred to the merging bank. The assets and liabilities of the Italian PE of the merged bank will be transferred to a new Italian PE of the merging bank.

The merger, as it involves two German companies, will be carried out pursuant to the German civil and tax legislation. The merger will have legal effects similar to the ones produced in a merger involving two Italian tax resident companies. After the transfer of all of the assets and liabilities of the merged company and the execution of the fulfilments requested by the German civil legislation to carry out this transaction, the merged company will cease to exist without being liquidated.

Moreover, for accounting purposes the assets and liabilities of the merged bank, including those of its Italian PE, will be transferred to the merging bank at their accounting value (and not at their fair value).

In this light, the merging company asked the Italian Tax Authorities:

- whether the Italian tax legislation providing for a tax neutrality regime for domestic merger can be applied to the merger at hand, with reference to the assets and liabilities of the Italian PE of the merged company, including the goodwill;
- what will be the tax value of the assets and liabilities of the new Italian PE resulting from the merger; and
- whether the merger can be backdated for Italian tax purposes.

In response, the Italian Tax Authorities affirmed that the EU Merger Directive cannot be applied to the merger at hand, as it is a merger between two companies which are resident for tax purposes in the same Member State. They affirmed that the Italian legislation, which stipulates that domestic mergers are tax-free for corporate income tax purposes, can also be applied to mergers between foreign companies which are not covered by the EU Merger Directive, as long as the following requirements are met:

- the transaction qualifies as a merger under the definition provided for by the Italian civil legislation;

- the companies involved in the merger have a legal form similar to the ones which can be adopted by companies incorporated in Italy; and
- the transaction affects the tax position of at least one of the companies involved in the merger.

Since the above-mentioned preconditions had been met in the merger at hand, the tax authorities have extended the tax neutrality regime applying to a domestic merger to the merger between the two German banks, with reference to the assets and liabilities of the Italian PE of the merged company. The tax authorities have pointed out that the extension is grounded on the fact that a merger does not constitute by itself a realisation of the transferred assets and liabilities. Accordingly, the tax value of the assets and liabilities of the new Italian PE will be attributed in the same way as the assets and liabilities of the old Italian PE. The Italian Tax Administration has affirmed that the merger at hand can be backdated for Italian tax purposes.

This is the first time that the Italian Tax Authorities have explicitly granted the possibility of extending the tax neutrality regime applying to domestic mergers to mergers between foreign companies, having Italian PEs which are not covered by the EU Merger Directive.

-- Claudio Valz and Giovanna Lembo, Italy; claudio.valz@it.pwc.com

Netherlands – Supreme Court orders disapplication of Dutch taxation rules on cars registered in another Member State as they infringe Art. 43 EC and 55 EC

On 14 November 2008, the Dutch Supreme Court (*Hoge Raad*) handed down its judgment in Case No. 40 597. The case concerned a Dutch provision on the taxation of registered cars. The system levies a single taxation of private cars or motorcycles, without taking into account the duration of the rental period and/or the total use of the car on the road network of the Netherlands.

According to the ECJ in the case *Ilhan* (Order, C-42/08), such provisions, which do not take the duration of the rental period/use of the vehicles into account, are contrary to Articles 43 EC and 55 EC. Given the fact that the Dutch provision is directly breaching EC Law, the Supreme Court is left with the question how to apply the Order of the ECJ in the *Ilhan* case. In such a situation, a national court can either disapply the conflicting measure as a whole (*disapplication*), or try to provide for a solution based on national law which does not constitute a restriction (*reading down*).

The Supreme Court reasons that a national judge *may* provide for a solution regarding the established shortcoming in national law on taxation, but only in cases where it is sufficiently clear which alternative taxation should apply. Such an alternative must be derived from the system of law, regulated cases in this law, applicable principles of law or the parliamentary history. Concluding, the Supreme Court tries to provide for a solution based on national law which does not constitute a restriction (*reading down)*, but if the national law does not provide any guidance on the specification of such a provision, the rule is disapplied as a whole (*disapplication).*

In this particular case, the aforementioned sources do not provide for an alternative application of the provision, which regulates the taxation of cars and motorcycles, when this provision would be considered as contrary to EC Law. As a result of the lack of any guidance regarding the application of the provision in this specific situation, the Supreme Court decided to disapply the national provision as a whole. Consequently, the tax assessment is annulled.

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

Portugal – Changes following the adoption of the State Budget for 2009

The State Budget has introduced changes to the Corporate Income Tax concerning the limitation of the application of the reduced withholding tax rate on interest and royalties, foreseen in the EU Interest & Royalty Directive (2003/49/EC). Following the ECJ decision in the Lankhorst-Hohorst case (C-324/00) and the subsequent change in Portuguese Law, with effect from 1 January 2006 onwards, that thin capitalisation rules do not apply in case the non-resident entity is resident in an EU Member State, the State Budget for 2009 has eliminated the limitation of the application of the reduced withholding tax rate on interest and royalties, foreseen in the EU Interest & Royalty Directive, based on the rules of thin capitalisation.

The new State Budget introduces changes to the Personal Income Tax Code allowing individuals to benefit from a deduction of tax due up to 30% of the expenditures incurred related to immovable property located not only in Portugal, but also in any other Member State of the EU, or of the EEA provided there is reciprocity of tax information.

In addition, the State Budget for 2009 introduces a rule that allows individuals resident in other EU Member States or in an EEA country (provided there is reciprocity of tax information) who render a certain type of services in Portugal to request the reimbursement, total or partial, of the withholding tax levied on the income derived from Portugal, under the same conditions and according to the same tax rates which apply to resident individuals. This rule is also applicable for Corporate Income Tax purposes, concerning companies resident in other EU Member States or in the EEA which render certain types of services in Portugal.

Furthermore, a new rule has been approved that allows individuals resident in other EU Member States or in the EEA (in a country with which there is reciprocity of tax information) to opt to be taxed in Portugal as a resident individual, in case at least 90% of their worldwide income derives from Portugal (this regime is only applicable to beneficiaries of employment income, business and professional income or pensions).

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

Portugal – Amendments to discriminatory taxation of lottery winnings

As reported in EUDTG Tax News 2008 – nr. 006, on 18 September 2008, the European Commission sent Portugal a formal request to amend its legislation which provides for the taxation of foreign lottery winnings whereas winnings from lotteries (*Euromilhões e Liga dos Milhões*) organised in Portugal by the *Santa Casa da Misericórdia de Lisboa* are not subject to taxation.

In response to the Commission's request, the Portuguese Government, as part of the approval of the State Budget for 2009, has introduced a change to the Personal Income Tax Code according to which winnings derived from lottery *Euromilhões* are no longer subject to taxation in Portugal.

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

Spain – Changes to corporate income tax and capital tax laws

On 23 December 2008, Law 4/2008, which amends several rules of the Spanish tax legislation with the aim of eliminating restrictions on the free movement of capital (Article 56 EC) and the freedom of establishment (Article 43 EC), was approved by the Spanish parliament. The amendments made were as follows:

a) Corporate Income Tax rules on participation exemption, controlled foreign companies and valuation of shares have been modified in order to eliminate restrictions on the free movement of capital and freedom of establishment.

   Tax benefits and exemptions derived from the above-mentioned rules were not applicable to entities that were tax resident in any of the tax haven countries or territories included in the Spanish black list, even though forming part of the EU and EEA, for instance, Cyprus. As from 1 January 2008, i.e. with retroactive effect, those tax benefits and exemptions also apply to those entities, although in these cases the taxpayer will have to prove first that the setting up and the operatiions of those entities correspond to valid economic reasons and second that they carry out business activities.

b) Following the ECJ's decision (C-248/06) of 13 March 2008, the Research and Development and Technological Innovation (R&D and TI) tax credit rules for Corporate Income Tax purposes have been modified. As from 1 January 2008, i.e. also with retroactive effect, R&D and TI activities and corresponding costs performed in any EU or EEA Member States receive the same beneficial treatment as the domestic ones.

c) Finally, the Capital Tax Law has also been modified, with effect as from 1 January 2009, in order to eliminate the capital tax (1%) for EU Head Office contributions to its Spanish permanent establishments.

-- Ramón Mullerat, José Blasi and Rui Dinis Nascimento, Spain;
jose.blasi@es.landwellglobal.com

Sweden – Amendments to company exit charge tax rules

On 18 September 2008, the European Commission formally requested Sweden to change its tax provisions which impose an immediate exit charge on companies that cease to be taxable in Sweden. The Commission, referring to case C-9/02 *De Lasteyrie du Saillant* and the Commission's Communication on exit taxation (COM(2006)825) of 19 December 2006, took the view that an immediate exit charge contravenes the freedom of establishment (see also EUDTG Tax News 2008 – nr. 006).

On 18 November 2008, the Swedish Government responded to the Commission that it had already started a legislative process with the aim of amending the Swedish exit charge rules no later than 1 January 2010, but that it did not share the Commission's view that the *De Lasteyrie du Saillant* case is applicable because that case concerned a private person and not a company. Indeed, it was a domestic court case that convinced the Swedish Government that the exit charge rules had to be amended.

As previously reported in EUDTG Tax News 2008 – nr. 003, the Swedish Supreme Administrative Court on 24 April 2008 found that it would contravene the freedom of establishment to impose an immediate exit charge when a Swedish company moved its place of effective management and control from Sweden to Malta thus becoming tax resident there (under the tie-breaker rule of the Swedish-Maltese tax treaty). Since all income came from real estate in the UK, the company would not be liable to tax in Sweden anymore. The court stated that the immediate exit charge was a disproportionate measure and thus could not be allowed.

With this judgement in mind, it is difficult for the Swedish Government not to amend the exit charge rules. The Swedish Government has not made any clear statement on how the rules will be amended, but it has stated that the Swedish court has suggested that it might be a more proportionate measure to levy the exit charge when the property in question actually is disposed of. This is probably the route that the Swedish Government will choose, since the Government notes that the Commission also seems to share the view that Sweden, after the migration, should be able to tax the income attributable to the period when the company was taxable in Sweden.

Nevertheless, it might be difficult to amend the legislation in that way without coming into conflict with the provisions in the double tax treaties that Sweden has concluded with other states. It can thus not be excluded that the Government will have to renegotiate the Swedish double tax treaties.

-- Gunnar Andersson and Fredrik Ohlsson, Sweden; gunnar.andersson@se.pwc.com

Switzerland – Announcement of corporate tax reforms

The Swiss Government has announced that it will prepare a legislative proposal which would lead to significant reforms to corporate taxation in Switzerland. The tax reform project is intended to relieve corporations from unnecessary tax burdens and to improve the country's overall position in today's field of international tax competition. The newly announced reforms follow various major tax reforms over the last decade aimed at maintaining and improving Switzerland's reputation as an attractive place for doing business.

The Swiss Government has proposed the abolition of the issuance stamp duty on the issue of equity and capital. In addition, intercompany transactions will be exempt from withholding taxes thus facilitating e.g. treasury activities and cash pooling in Switzerland. Furthermore, the cantons will be permitted to abolish their annual tax on equity capital. Finally, certain elements of the cantonal tax statuses (holding companies, mixed companies and domiciliary companies) will be amended. Holding companies would be precluded from carrying out commercial activities abroad, domestic and foreign revenues of mixed companies would be taxed equally, and domiciliary companies would be abolished to the extent that they do not invest and create jobs in Switzerland. The Swiss Government expects that these measures will enhance the acceptance of these companies abroad. At the same time, these measures shall take into account the concerns raised by the European Commission in the past.

Recently, the delegations of the Commission and the Swiss Government met in Brussels where the newly proposed amendments were discussed as well. EU Commission President Barroso has called the proposal a "step in the right direction". Switzerland and the EU are still in disagreement as to whether some elements of the Swiss tax statuses are compatible with the 1972 EU-Swiss bilateral free trade agreement and its State aid clause. See also EUDTG Tax News 2008 – nr 002.

It is anticipated that the Swiss parliament will not debate the legislative proposal before the end of 2009. The tax reform is expected to enter into force in 2011 at the earliest and will include a number of transitional rules. Corporations in Switzerland will thus have the necessary time to adapt to the new rules.

-- Armin Marti and Robert Desax, Switzerland; armin.marti@ch.pwc.com

United Kingdom – High Court judgment in FII GLO

The English High Court gave its decision on the various issues raised in the FII GLO on 27 November 2008, following the ECJ judgment of 12 December 2006. The lengthy judgment covered a number of different issues. In brief summary:

- The differential UK corporation taxation treatment of dividends from EU or EEA companies (taxable with credit) and dividends from UK companies (exempt) is contrary to Article 43 EC. The differential corporation taxation treatment of dividends on majority shareholdings from Third Countries is contrary to Article 56 EC, but is permitted by Article 57 EC (being a measure that was in place at 31 December 1993).

- Where a UK company received dividends from taxpaying EU or EEA companies, the requirement for the UK company to account for ACT on dividends it subsequently paid was contrary to Article 43 EC. However, the question of whether there was a breach of the EC Treaty in circumstances where (i) the UK recipient company did not itself pay ACT, but ACT was paid by another UK group company higher up the ownership chain, and / or (ii) the EU/EEA company did not itself pay tax, but tax was paid by other companies further down the ownership chain (referred to as the 'corporate tree' issues), will have to be referred back to the ECJ.

- Where a UK company paid ACT in respect of a dividend, the inability to surrender that ACT to EU or EEA subsidiaries with UK permanent establishments was contrary to Article 43 EC. However, the question of whether the inability to surrender ACT to EU or EEA subsidiaries without any UK permanent establishment is contrary to the EC Treaty will have to be referred back to the ECJ.

- The UK foreign income dividend (FID) regime was contrary to Article 43 EC and Article 56 EC, and the grandfathering provisions of Article 57 EC do not apply, such that the taxpayer is entitled to a remedy in respect of both EU or EEA dividends and Third Country dividends. However, the taxpayer is not entitled to compensation where it paid 'enhanced' FIDs to compensate shareholders for the lack of a tax credit.

- Taxpayers were seeking as remedies both restitution for tax paid under a mistake of law, and damages. It was held that, in situations where tax had been paid under provisions which have been found to be in breach of the EC Treaty, the taxpayers are entitled to restitution, being repayment of the tax plus compound interest. However, the taxpayer is not entitled to restitution in situations where no tax was paid, for example, where losses were offset against EU dividends received such that there were no net taxable profits. Furthermore, taxpayers are not entitled to damages as the breaches of the EC Treaty were not 'sufficiently serious'.

- The reduced time limits for making common law claims for restitution for tax paid under a mistake of law introduced in Finance Act 2004 s320 and Finance Act 2007 s107 must be disapplied since they did not include any transitional provisions. This means that taxpayers may be able to claim restitution for taxes paid as far back as 1973.

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

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EU DEVELOPMENTS

EU – Main results of the December 2008 European summit and direct tax policy outlook for 2009

At the European Council summit in Brussels on 11-12 December 2008, EU leaders re-affirmed that the Treaty of Lisbon is necessary in order to help the enlarged EU to function more efficiently and more democratically. The French six month EU Council Presidency was successful in breaking the political stalemate on the future of the EU following the Irish no-vote on the new treaty in June 2008. The French Presidency brokered a deal to enable the new treaty to enter into force by the end of 2009 (instead of 31 January 2009 as originally foreseen). The Irish Government secured a number of concessions and clarifications, dubbed as legal guarantees in the official French Council Presidency Conclusions, from the governments of the other EU Member States, including on taxation.

This new legal guarantee on taxation is interesting since the Treaty of Lisbon brings no changes to the decision making process in the field of taxation: this will remain based on unanimity. Any revised proposal for a CCCTB directive would for instance require an unanimous decision and could thus still be blocked by one Member State. This diplomatically hard-fought legal guarantee then, is in effect nothing more than a reiteration of the status quo which seems intended to reassure the Irish voters ahead of the second referendum and counteract the (unfounded) insinuations which were made by the Irish no-campaign during the referendum campaign last year, that the Treaty of Lisbon would curb Ireland's room for manoeuvrability on (direct) tax policy.

The new legal guarantee obtained from "Europe" was a relative diplomatic victory for the Irish but a highly significant and symbolical one for domestic purposes: the Irish Government could show the Irish people that the issues which had been raised during the campaign had been addressed with the EU. This result should help the Irish Government in promoting the vote for the Treaty of Lisbon and proactively neutralising the Irish no-campaign.

In terms of the likely date for holding the second referendum, Irish government officials are probably contemplating three possible options: April, June or October 2009. The most likely scenario is probably June 2009 so that the referendum can be held commensurate with the European Parliament elections in Ireland, even though Irish Prime Minister Brian Cowen has recently said that he may want to hold the second referendum sooner rather than later because of the economic crisis. Holding the second referendum in June 2009 would save organisational costs, and, more importantly, is expected to lead to much higher voter turn-out for the European Parliament elections than would otherwise be the case. The main Irish political parties are therefore likely to have a preference for June 2009.

The second Irish referendum and the European Parliament elections in June are part of a total changeover of the political constellation of EU (direct) taxation that will take place this year. On June 1 2009, Walter Deffaa (German), Internal Auditor of the Commission and Director-General of the IAS, will replace Robert Verrue (French) after seven years as Director-General of DG TAXUD. Phillip Kermode (Irish) became the new Director Analyses and Tax Policies at DG TAXUD in October 2008, replacing Matthias Mors (German), who had replaced Michel Aujean (French) in December 2007. The Swedish EU Presidency will take over from the Czechs on July 1 2009, and in November 2009, a new EU Tax Commissioner will start his five year leadership at DG TAXUD. It remains to be seen how all these changes will affect the work and output of DG TAXUD in 2009, and, in particular, progress on the draft proposal for a CCCTB Directive.

-- Bob van der Made, Netherlands; bob.van.der.made@nl.pwc.com

EU – Main conclusions of the 2 December 2008 ECOFIN Council

The ECOFIN Council held on 2 December 2008 saw the following main results related to direct taxation:

- The Council reached political agreement on four key draft directives: solvency for insurance companies ("Solvency II" directive), banks' capital requirements, the functioning of UCITS (undertakings for collective investment in transferable securities), and bank deposit guarantee systems;

- The Council adopted the work programme of the Code of Conduct Group for business taxation for the next 18 months. The report clarifies the Group's operating rules and sets its new areas of investigation.

- The following Council Resolution was adopted on the coordination of direct tax systems in respect of exit taxes:

> “Emphasising that any solution put forward to achieve these objectives must be pragmatic, based as far as possible on existing instruments, including the bilateral double taxation conventions, restrict the administrative burden on taxpayers and authorities, and safeguard the legitimate financial interests of the Member States,
> Emphasising, furthermore, that the guiding principles are a political commitment, whose implementation is left to the decision of the Member States, and therefore affect neither the rights and obligations of the Member States nor the respective competencies of the Member States and of the Community under the Treaty,
>
> Invites the Member States to adopt the following guiding principles:
>
> A. "Transfer of economic activities" means any operation whereby a taxpayer subject to corporation tax or a natural person engaged in a business:
>
> 1) ceases to be subject to corporate or personal income tax in a Member State (the exit State) while at the same time becoming subject to corporate or personal income tax in another Member State (the host State); or
> 2) transfers a combination of assets and liabilities from a head office or a permanent establishment in the exit State to a permanent establishment or a head office in the host State.
>
> B. When, in connection with a transfer of economic activities, the exit State reserves the option to exercise its taxing rights on the reserves made (profits realised but not yet taken into account for tax purposes) and to take back, in full or in part, the provisions made (expenditure not yet incurred but already taken into account for tax purposes), the host State may provide for the creation of reserves or provisions of identical or different amounts, in

accordance with the rules governing the tax base in that State, and allow deduction from taxable results for the year in which they were established.

C. When, in connection with a transfer of economic activities, the exit State reserves the option to exercise its taxing rights on the unrealised gains corresponding to the assets held by the taxpayer, calculated as the difference between the market value of these assets on the transfer date and their book value, the host State takes the market value on the transfer date when calculating the subsequent added value in the event of disposal.

D. In case of disagreement between the host State and the exit State regarding the market value of the assets on the transfer date, the two States settle their dispute using the appropriate procedure.

E. The host State can require the taxpayer engaged in a transfer of economic activities to provide evidence that the exit State has exercised or will exercise its rights under the conditions set out above, as well as evidence of the market value applied by the exit State.

F. The provisions laid down at Community level in relation to Mutual Assistance provide the framework for the host State to assist the exit State, in particular for the purposes of determining the disposal date."

Click here for the full ECOFIN Council Conclusions.

-- Bob van der Made, Netherlands; bob.van.der.made@nl.pwc.com

EU – European Commission launches new Savings Tax Directive proposal

On 13 November 2008, the European Commission announced the adoption of an amending proposal to the EU's Savings Tax Directive "with a view to closing existing loopholes and eliminating tax evasion". The Commission wants to better ensure that interest payments channelled through intermediate tax-exempt structures are taxed, extend the scope of the Directive, and simplify and improve the technical operation and implementation of the Directive.

Determining the effective beneficial owner of interest payments

Regarding interest payments made by paying agents established in the EU (banks, financial institutions, independent professionals, etc.) to certain intermediate structures established outside the EU, the Commission proposes that paying agents in the EU apply the provisions of the Directive (exchange of information or withholding tax) at the time of the payment to the intermediate structure, as if this payment was directly made to the individual.

Concerning payments of interest to certain intermediate structures established within the EU, including some non-charitable trusts and foundations, those structures will be always obliged to act as a "paying agent upon receipt". This means that the provisions of the Directive (exchange of information or withholding tax) must be applied by these structures upon receipt of any interest payment from any upstream economic operator (bank, financial institution, independent professional), no matter where they are established and regardless of the actual distribution of any sums to the individual beneficial owners. The suggested definition of "paying agent upon receipt" includes all entities and legal arrangements (trust foundations etc) which are not taxed on their income under the general rules for direct taxation in their Member State of residence/establishment.

Extending the scope to income equivalent to interest payments

The Commission proposes to extend the scope of the Directive to income from:

1) securities which are equivalent to debt claims (of which the capital is protected and the return on investment is pre-defined),
2) life insurance contracts whose performance is strictly linked to income from debt claims or equivalent income and have less than 5% risk coverage.

Income from investment funds

In addition, the Commission proposal seeks to ensure a level playing field between all investment funds or schemes (be it undertakings for collective investment in transferable securities authorised in accordance with the UCITS Directive or not), independently of their legal form. This means that income obtained from those investment funds by individuals resident in the EU will be subject to effective taxation.

Click here for more information on the Commission's proposal.

-- Bob van der Made, Netherlands; bob.van.der.made@nl.pwc.com

Estonia – European Commission requests Estonia to end discrimination against foreign charities

On 27 November 2008, the European Commission sent a formal request to Estonia to end its discriminatory treatment of donations to foreign non-profit organisations and foundations (charities).

Under Estonian income tax law, individuals are allowed to deduct documented gifts and donations to charities approved by the government and included in a special list. The total deduction related to the gifts and donations may not exceed 5% of the individual's income in the tax year, after the deduction of other allowable expenses. Similar incentive applies to Estonian companies, for whom donations made to qualified charities are exempt from (deferred) corporate tax up to 3% of the amount of personalised social tax due for the current year or up to 10% of the annual profits for the previous financial year, whichever is higher. However, the favourable treatment of gifts and donations is only granted if the charity is established in Estonia and has been included in the special list of qualified charities.

The beneficial treatment of donations made by individuals or companies is also extended to scientific, cultural, sports, educational, health or social security institutions belonging to the state or local authorities, to nature reserves and to public universities, and to religious organisations. No relief is granted, however, to donations to similar foreign bodies and organisations.

According to the Commission such differential treatment of donations made to charities in Estonia and charities in other Member States constitutes an obstacle to the free movement of capital (Article 56 EC) and the freedom of establishment (Art 43 EC).

In the light of existing case law e.g. case C-386/04 (*Stauffer)* and the AG's Opinion in Case C-318/07 (*Persche*), it seems likely that Estonia has no other choice but to change its laws (or interpretations) on taxation of donations made to foreign charities.

The Commission's request takes the form of a Reasoned Opinion, the second step of the infringement procedure under Article 226 EC. If Estonia does not reply satisfactorily to the Reasoned Opinion within two months the Commission may refer the matter to the ECJ.

-- Erki Uustalu and Iren Koplimets; Estonia; erki.uustalu@ee.pwc.com

Portugal – European Commission requests Portugal to change its restrictive exit tax provisions for companies

On 27 November 2008, the Commission sent a Reasoned Opinion, the second stage of the EU infringement procedure under Article 226 EC, to Portugal demanding it to amend its tax provisions which allow immediate exit taxes when companies cease to be tax resident in Portugal or transfer their assets to another Member State.

According to Articles 76-A and 76-B of the Portuguese Corporate Income Tax (CIT) Code, in case of transfer of seat and place of effective management of a Portuguese company to another Member State, or in case a permanent establishment of a non-resident entity ceases its activities in Portugal or transfers its assets located in Portugal to another Member State, the taxable base of that financial year will include any unrealised capital gains in respect of the company's assets, whereas unrealised capital gains from purely domestic transactions are not included in the taxable base.

Moreover, Article 76-C of the CIT Code foresees that the shareholders of the company that transfers its seat and place of effective management from Portugal to another country are subject to tax on the difference between the company's net assets (value at the time of the transfer at market prices) and the acquisition cost of their participation.

In this context, companies that leave Portugal or transfer their assets abroad are subject to an immediate taxation, compared to companies which remain in Portugal or transfer their assets domestically.

The Commission considers that this difference of treatment dissuades companies from exercising their right of freedom of establishment and, as a result, constitutes a restriction of Article 43 EC Treaty and the corresponding provision of the EEA Agreement. If Portugal does not reply satisfactorily to the Reasoned Opinion within two months, the Commission may refer the matter to the ECJ.

The Commission's case reference number is 2007/2365.

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

Spain – European Commission requests Spain to change its restrictive exit tax provisions for companies

On 27 November 2008, the European Commission sent a Reasoned Opinion to Spain demanding it to amend its restrictive exit tax provisions for companies when they cease to be tax residents in Spain or transfer their assets to another EU Member State. The Reasoned Opinion is the second step of the three-step infringement proceedings under Art 226 EC.

Under Spanish tax law, when a company transfers its residence to another Member State, when a permanent establishment ceases its activities in Spain or transfers its Spanish assets to another Member State, unrealised capital gains must be included in the taxable base of that financial year, whereas unrealised capital gains from purely domestic transactions are not subject to any such obligations.

The Commission holds that the above-mentioned Spanish regime introduces a less favourable regime for the companies that wish to leave Spain or transfer taxes abroad, compared with those that remain in the country or transfer assets domestically. As such, the Spanish provisions are likely to dissuade companies from exercising their right to the freedom of establishment (Article 43 EC) since such immediate taxation penalises those individuals who decide to leave Spain by introducing less favourable treatment for them as compared to those who remain in Spain.

If Spain does not comply with the Reasoned Opinion within two months, the Commission may decide to refer the matter to the ECJ. The Commission's case reference number is 2007/2382.

-- Ramón Mullerat, José Blasi and Rui Dinis Nascimento, Spain;
jose.blasi@es.landwellglobal.com

United Kingdom – European Commision requests UK to allow deductibility of cross-border pension contributions

On 27 November 2008 the European Commission sent a formal request to the UK to allow deductibility for all pension contributions paid by resident taxpayers to funds established in other EU and EEA Member States. The request takes the form of a Reasoned Opinion (second step of the infringement procedure provided in Art 226 EC).

The reasoned opinion concerns the UK income tax rules which deny workers established in the UK the right to deduct pension contributions they pay to pension funds established elsewhere in the EU or the EEA from their UK taxable income if the overseas pensions fund does not provide certain information to the UK tax authorities. The Commission considers that the rules may dissuade a person resident in another Member State from exercising his right of free movement by taking up employment in the UK.

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

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STATE AID

France – ECJ rules that France has failed to fulfil its obligations under EC Law to recover illegal State aid

The ECJ has ruled in case C-214/07 that France has failed to meet its obligations under EC Law with respect to the recovery of illegal State aid. The French Government had argued that the recovery was impossible due to a variety of problems. According to the ECJ, the mere assertion that recovery is impossible is insufficient to warrant the conclusion that recovery is absolutely impossible. Instead, France should have taken concrete steps aimed at recovery, or proposed alternative arrangements aimed at overcoming the difficulties.

In its decision 2004/343/EC of 16 December 2003, the Commission decided that the French scheme of corporate, business and property tax exemptions for companies created to take over the activities of industrial firms in difficulty, introduced in 1989 without prior notification to the Commission constituted an illegal State aid. The tax regime had been used by hundreds of companies.

The decision stated that France should inform the Commission, within a two-month period, of the measures taken and to be taken in order to comply with it. France had also been asked to list all companies that received such exemptions, and a list of those companies which did not fulfil the de minimis rule, the 1979 communication on regional aid system or the 1998 guidelines on national regional aid. Following various exchanges after the expiry of the two-month period, and considering that France did not give sufficient effect to its decision, the Commission decided to bring an action at ECJ level.

France claimed that it was impossible to recover the aid from the beneficiaries, especially for those having ceased their activities.

Following AG Sharpston's Opinion, and according to settled case-law, the ECJ reiterates that the condition according to which States may not have to recover State aid (i.e. if it is absolutely impossible to implement such a recovery decision) is not fulfilled where the Member State merely informs the Commission of the legal, political or practical difficulties involved in implementing the decision, without taking any real steps to recover the aid, or without proposing any alternative arrangements in order to overcome those difficulties.

With regard to the recipients that have not ceased their activity, the ECJ criticizes the fact that no concrete steps have been taken to recover illegal aid, although those companies had been identified by the French authorities.

With regard to the recipients that have ceased their activity, the ECJ states that the liability should be registered in the schedule of liabilities; in case the period for registration has expired, any available procedure must be applied to lift a time-bar so as to allow the presentation of claims out of time.

Finally, with regards to the recipients which have transferred their assets, the authorities must check whether the financial conditions of the transfer were made at market conditions, as this is the only way to demonstrate that the acquirer did not benefit from the State aid.

The ECJ refuses to consider that it was absolutely impossible for France to implement the Commission's decision.

-- Nicolas Jacquot and Emmanuel Raingeard, France; jacques.taquet@fr.landwellglobal.com

Gibraltar – European Court of First Instance annuls European Commission Decision according to which the proposed reform of corporation tax in Gibraltar is unlawful State aid

On 18 December 2008, in the European Commission vs. Gibraltar (Cases T-211/04 and T-215/04), the European Court of First Instance annulled an earlier Decision by the European Commission according to which the proposed Gibraltar coporate tax reform consititutes unlawful State aid.

On 11 July 2002, the Commission informed the UK that it would initiate investigation procedures into Gibraltar exempt and qualifying companies as according to the Commission these tax concessions constituted state aid, contrary to the rules of the common market.

The Court overturned the Commission's decision with regard to exempt companies, however it did accept the Commission's view with regard to qualifying companies. It was therefore agreed that the qualifying company regime would be terminated in the short term, but existing exempt companies would be phased out by December 2010. The Gibraltar Government then sought to reform its corporate income tax system which would be applicable to all companies incorporated in Gibraltar. On 30 March 2004, the Commission decided that the proposed tax reforms constituted state aid incompatible with the common market and rejected the proposals. The Commission considered the reform proposals to be:

(1) 'Regionally selective' in that they conferred tax advantages on companies in Gibraltar compared with companies in the UK (therefore implying that Gibraltar is a mere region of the UK and not an independent territory for tax purposes); and

(2) 'Materially selective' in that specific features conferred tax advantages on some companies as opposed to others in Gibraltar.

The Governments of Gibraltar and the UK brought an action against the Commission on 9 June 2004 contesting the Commission's 2004 decision arguing that their tax jurisdictions are entirely separate so that Gibraltar's tax laws cannot be treated as derogations from the tax laws applicable in the UK. Furthermore, Gibraltar argued that the reform proposals cannot be treated as derogations from the common tax regime resulting in favouring certain undertakings in Gibraltar.

On 18 December 2008 the Court of First Instance annulled 'in its entirety' the Commission's decision. The Court concluded that the tax reform proposals cannot be deemed to be considered regionally selective. The Court also concluded that the classification by the Commission of the Gibraltar proposed tax measures as materially selective was incorrect because the Commission had not established the existence of selective advantage for these measures. The Commission may appeal only on points of law within two months after notification.

It is anticipated that the Government of Gibraltar will move to reduce the rate of corporation tax from the current 27% to around 10% no later than 2011 and possibly earlier. Since 2004, the Government of Gibraltar has proactively introduced a series of measures to ensure that Gibraltar remains an attractive location for the establishment of holding companies including the exemption from tax on interest income, on dividends from listed securities and from relevant participations, and on dividends paid to non-resident shareholders and other Gibraltar companies.

-- Robert Guest, Christopher Pitaluga and Raacida Amenzou, Gibraltar; robert.g.guest@gi.pwc.com

Italy – New rules for recovery of State aid granted to Italian utilities with a majority public capital holding

By means of the Decree Law Nr. 185 of 29 November 2008 the Italian Government has adopted new legal provisions in order to recover the State aid granted in the form of exemption from the corporate income taxes to Italian utilities with a majority public capital holding.

Since the 1990s, the Italian parliament has adopted several laws to create legal bodies available to municipalities to provide utilities services. Section 22 of Law Nr. 142 of 8 June 1990 enabled municipalities to render such services also through a separate administrative accounting entity ("azienda speciale") or by a joint-stock company ("società per azioni") with a majority public shareholding. In order to push the incorporation of joint-stock companies, the parliament granted several tax advantages to the newly incorporated companies.

For instance, pursuant to section 3, para 70, of Law Nr. 549 of 28 December 1995 and section 66, para 14, of Decree Law Nr. 331 of 30 August 1993, joint-stock companies set-up under Law Nr. 140 of 1990 were corporate income tax exempt for three tax years after their incorporation, yet not beyond the tax year ending on 31 December 1999.

On 5 June 2002, the European Commission issued Decision Nr. 2003/193/EC declaring that the mentioned three-year exemption from corporate income taxes constituted illegal State aid and that the State aid had to be recovered by the Italian State. Following the Commission's decision, the Italian parliament adopted the first law measures to recover the State aid by means of Law Nr. 62 of 18 April 2005, which stipulated that the beneficiaries of the aid had to file the tax returns relevant to the tax years for which they benefited from the corporate income taxes exemption. However, as Italy had failed to recover the aid within the period prescribed by the Commission, the latter referred Italy to the ECJ (C-207/05). The ECJ declared the failure of the recovery by the Italian State on 1 June 2006.

Subsequently, as the aid had not been recovered after the ECJ decision yet, the Commission decided to open a new infringement procedure (2006/2456) in order to speed up the recovery.

After the new infringement procedure, Italy adopted several law measures to recover the State aid. Section 1 of Decree Law Nr. 10 of 15 February 2007 (converted into the Law Nr. 46 of 8 April 2008) ordered the recovery by the Italian Tax Authorities by means of injunctions. However, the aid was not fully recovered, partly because of the appeals submitted to the local tax courts by the beneficiaries against such injunctions.

As a consequence, the Italian Government was forced to adopt new administrative rules, laid down in section 24 of Decree Law Nr. 185 of 29 November 2008, in order to recover the aid. The new provisions give the Italian Tax Authorities the power to recover the aid pursuant to the ordinary assessment and liquidation procedures provided for by the Italian tax legislation with reference to direct income taxes. Based on the new measures, the Italian Tax Authorities will have to recover the aid by issuing notices of assessment to be notified to the beneficiaries within 120 days from the entry into force of the same Decree Law and the beneficiaries will have to pay within 30 days from the receipt of such notices.

If Italy fails to recover the aid, the Commission may bring the case before the ECJ again. In that case, Italy may be sentenced by the ECJ to not only recover the aid but also pay a lump-sum amount or penalty as a consequence of the failure to recover the State aid.

-- Claudio Valz and Giovanna Lembo, Italy; claudio.valz@it.pwc.com

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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).

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

*connectedthinking

EUDTG CONTACT LIST

Chairman:
Frank Engelen frank.engelen@nl.pwc.com

EUDTG Secretariat:
Bob van der Made bob.van.der.made@nl.pwc.com

Country contacts:

Austria	Friedrich Roedler	friedrich.roedler@at.pwc.com
Belgium	Olivier Hermand	olivier.hermand@pwc.be
Bulgaria	Georgy Sarakostov	georgy.sarakostov@bg.pwc.com
Cyprus	Marios Andreou	marios.andreou@cy.pwc.com
Czech Rep.	Zenon Folwarczny	zenon.folwarczny@cz.pwc.com
Denmark	Ann-Christin Holmberg	ann-christin.holmberg@dk.pwc.com
Estonia	Erki Uustalu	erki.uustalu@ee.pwc.com
Finland	Karin Svennas	karin.svennas@fi.pwc.com
France	Jacques Tacquet	jacques.taquet@fr.landwellglobal.com
Germany	Juergen Luedicke	juergen.luedicke@de.pwc.com
Greece	Alexandros Sakipis	alexandros.sakipis@gr.pwc.com
Hungary	Gabriella Erdos	gabriella.erdos@hu.pwc.com
Iceland	Fridgeir Sigurdsson	fridgeir.sigurdsson@is.pwc.com
Ireland	Anne Harvey	anne.harvey@ie.pwc.com
Italy	Claudio Valz	claudio.valz@it.pwc.com
Latvia	Zlata Elksnina	zlata.elksnina@lv.pwc.com
Lithuania	Kristina Bartuseviciene	kristina.bartuseviciene@lt.pwc.com
Luxembourg	Álina Macovei-Grencon	alina.macovei-grencon@lu.pwc.com
Malta	Kevin Valenzia	kevin.valenzia@mt.pwc.com
Netherlands	Frank Engelen	frank.engelen@nl.pwc.com
Norway	Aleksander Grydeland	aleksander.grydeland@no.pwc.com
Poland	Camiel van der Meij	camiel.van.der.meij@pl.pwc.com
Portugal	Jorge Figueiredo	jorge.figueiredo@pt.pwc.com
Romania	Mihaela Mitroi	mihaela.mitroi@ro.pwc.com
Slovakia	Todd Bradshaw	todd.bradshaw@sk.pwc.com
Slovenia	Janos Kelemen	janos.kelemen@si.pwc.com
Spain:	José Blasi	jose.blasi@es.landwellglobal.com
Sweden:	Gunnar Andersson	gunnar.andersson@se.pwc.com
Switzerland	Armin Marti	armin.marti@ch.pwc.com
UK	Peter Cussons	peter.cussons@uk.pwc.com

CCCTB central contact:
Peter Cussons peter.cussons@uk.pwc.com

EU State aid central contact:
Pieter van der Vegt pieter.van.der.vegt@nl.pwc.com