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ECJ CASES

Austria – ECJ referral on Austrian taxation of portfolio dividends: Haribo case ([C-436/08](#) and [C-437/08](#))

In April 2008, the Austrian Administrative High Court decided that the Austrian tax treatment of foreign portfolio investments at the level of Austrian holding companies is contrary to Article 56 EC as foreign portfolio investments are discriminated against vis-à-vis domestic portfolio investments (Decision 2008/15/0064, see also: EU Tax News [2008 – nr. 005](#)).

Domestic dividend payments – irrespective of the amount of participation – are tax exempt at the level of the Austrian holding company, whereas dividends received from foreign entities are treated tax neutral under the international participation exemption. However, in order to qualify for the international participation exemption, the investment must amount to at least ten per cent of the foreign company's share capital (beside some other requirements) which results in a different treatment of foreign and domestic portfolio dividends. This approach was qualified by the High Court as not in line with Article 56 EC. However, the High Court did not consider it necessary to apply the exemption method with regards to foreign portfolio dividends as it is done for domestic portfolio dividends because the court regarded the application of the credit method as complying with Article 56 EC as well.

The differentiation of the High Court between domestic and foreign portfolio dividends has been strongly criticised by Austrian tax experts. The Austrian Fiscal Court of Appeal (UFS Linz) has now referred the following questions to the ECJ in two cases (C-436/08 and C-437/08):

The questions forwarded by UFS Linz to the ECJ were the following:

- Does the approach of the Austrian Administrative High Court (application of credit method instead of exemption method) to foreign portfolio dividends comply with EC law?
- Does the application of the credit method to foreign portfolio dividends comply with EC Law taking into consideration the huge administrative efforts to be made by the holding company in order to get a tax credit?
- If the credit method applied to foreign portfolio dividends is in line with EC Law, does it make a difference whether the Directive on mutual assistance is applicable in respect to the compliance with Austrian documentation requirements (documentation of foreign CIT burden)?
- Which technical approach has to be applied at the level of Austrian holding companies with regards to portfolio dividends from third countries (credit method, exemption method, no relief)?
- In years where no credit of foreign CIT can be achieved due to a loss position of the Austrian holding company, is there a requirement under EC Law to grant a corresponding refund or at least a carry forward of the tax credit? In this respect, does it make any difference whether portfolio dividends were distributed by EU Member States resident companies or third countries resident companies?

- Is it contrary to EC Law that under Austrian tax law a refund or a carry forward of foreign tax withheld on portfolio dividends is not allowed? In this respect, does it make any difference whether portfolio dividends were distributed by EU Member States resident companies or third countries resident companies ?

From the High Court's decision on the treatment of foreign portfolio dividends it can be derived that the former Austrian approach (no credit of foreign CIT) was not in line with Article 56 EC. However, apart from that conclusion it appears that many questions still have to be answered by the ECJ to obtain full legal certainty with regard to the correct tax treatment of foreign portfolio dividends and the associated administrative requirements.

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

Belgium – ECJ judgment on the Belgian Participation Exemption Regime: Cobelfret case (C-138/07)

On 12 February 2009, the ECJ ruled that the Belgian Participation Exemption Regime is not in line with the EU's Parent-Subsidiary Directive.

The Court of Appeal of Antwerp, Belgium, had asked the ECJ whether Article 4 of the Parent-Subsidiary Directive precludes national legislation under which dividends received are first included in the basis of assessment of the parent company and subsequently deducted only as far as the parent company has taxable profits.

To the extent the dividends paid to the parent exceed the parent company's total profit, the amount of carry forward losses will be reduced. As the purpose of the Directive is to prevent economic double taxation, the reduction of losses is obviously not allowed. Indeed, corporate tax is levied in following years in which taxable profits will be made up to the amount corresponding to a part or all the dividends previously received.

The ECJ ruled against that regime by stating that such a conditional exemption is not in line with the Directive. The ECJ decided not to limit in time the effect of its decision.

Practically speaking, Belgian companies should assess the opportunity to file claims to benefit from this decision.

Finally, the ECJ ruled that the first indent of Article 4(1) of the Directive is unconditional and sufficiently precise to be directly applied by national courts.

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

Germany – ECJ judgment on German tax treatment of donations to foreign charities: Persche case (C-318/07)

On 27 January 2009, the ECJ decided in the *Persche* case, where a German resident claimed the deduction of a donation of everyday consumer goods to a value of 18.180 EURO that he made to a Portuguese nursing home, which was recognised as charitable in Portugal. The

German Tax Authorities denied the deduction of these expenses sought on the ground that the beneficiary is not established in Germany. In its referral, the German Federal Tax Court had asked the ECJ whether Articles 56 EC to 58 EC are applicable to a donation of everyday consumer goods and, if so, whether those articles preclude a Member State from allowing the deduction for tax purposes of such a gift only if the recipient is established in its national territory.

Firstly, the ECJ states that the tax treatment of gifts in money or in kind falls under the scope of the Treaty provisions about the free movement of capital. Since the possibility of obtaining a deduction for tax purposes can have a significant influence on the donor's attitude, the inability in Germany to deduct gifts to foreign charities is likely to affect the willingness of German taxpayers to donate and therefore constitutes an obstacle to the free movement of capital.

Secondly, the ECJ rules out the argument that a foreign recipient of the donation could be in a different situation than a domestic recipient. Even though the tax benefit granted to domestic charities might be compensated by the effect that those charities substitute themselves for the public authorities in assuming certain responsibilities, it does not follow that a Member State can introduce a different tax treatment depending on whether or not such budgetary compensation arises. The need to prevent the reduction of tax revenues is neither among the objectives stated in Article 58 EC nor an overriding reason in the public interest capable of justifying a restriction on a freedom.

Furthermore, where a charity which is established in one Member State satisfies the requirements imposed by another Member State for the grant of tax advantages, a domestic and a foreign charity are in comparable situations and therefore have to be treated equally by the latter Member State.

The ECJ comes to the conclusion that the limitation of deductibility of donations cannot be justified by the need to ensure the effectiveness of fiscal supervision. The ECJ points out that according to German provisions any donation to a foreign charity is not deductible and argues that such restriction does not comply with the principle of proportionality, since German Tax authorities could require the taxpayer to provide the relevant evidence to show that the foreign charity meets the German requirements without being confronted with excessive administrative burden. Tax authorities themselves may decide whether the information provided is sufficient for their purposes and nothing would prevent them from refusing the deduction applied for if the evidence they consider to be necessary will not be delivered. Apart from this, tax authorities could rely on Directive 77/799 in order to obtain any outstanding information.

Since according to German law, taxpayers do not have any chance to prove that foreign charities meet the German requirements, the ECJ declares the regulations to be in breach of the principle of free movement of capital.

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Germany – ECJ judgment on double (inheritance) taxation: Block case ([C-67/08](#))

On 12 February 2009, the ECJ delivered a judgment without prior opinion of the Advocate General in which it held that the free movement of capital does not require a Member State to credit foreign inheritance tax levied by another Member State on a claim due from a foreign bank against domestic inheritance tax payable on that claim.

The German resident Margarete Block is the sole heir to her aunt who had died during her residency in Germany in 1999. The deceased's estate includes the equivalent of around 1 million Deutschmark deposited in a Spanish bank account on which Spanish inheritance tax was levied. Mrs. Block's request to have the Spanish inheritance tax credited on the inheritance tax payable in Germany was denied with respect to German inheritance tax legislation. According to these rules, a foreign tax credit is not available for assets which, as deposits in foreign banks, are deemed domestic.

Upon appeal, the Supreme Tax Court considered that the imposition of both German and Spanish inheritance tax possibly infringes Article 56 EC as the ensuing double taxation could prevent a person from investing money abroad. It also raised the question that these provisions which predate 1993 may fall under the grandfather rule in Article 58(1) a EC (as interpreted in Declaration No 7 annexed to the EC Treaty) despite the fact that the inheritance tax act was amended in 1997.

By referring to the catalogue in the Appendix I of the Directive 88/361, the ECJ found that the inheritance of a claim against a foreign bank between two nationals of the same Member State falls under Article 56(1) EC. It denied, however, a restriction of the free movement of capital since the location of the financial institute keeping the account is irrelevant as German inheritance tax would be levied in any case.

The ECJ, moreover, did not find the risk of double taxation to be decisive of the matter. Even though the absence of a right to credit would in fact lead to a higher tax burden when money is deposited in a foreign bank, it regarded such disadvantage as the result of both Member States exercising their right of taxation. EC Law at the current stage of its development would not offer any criteria of how to attribute the right of taxation between different Member States. In the absence of harmonised rules, the ECJ held that Member States have a certain degree of autonomy and are not obliged to adapt their tax system to that of other Member States in order to eliminate double taxation. Germany would thus be free to make capital claims subject to its inheritance tax where the creditor is resident in Germany, while Spain could exercise its taxing right based on the link with the debtor of the claim.

As there was no infringement of EC Law, the ECJ did not have to deal with the question on the stand-still clause.

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Germany - ECJ judgment on German tax treatment of write-downs on foreign shareholdings in 2001: Steko case ([C-377/07](#))

On 22 January 2009, the ECJ gave its decision in the *Steko* case without an opinion of an Advocate General. The ECJ ruled that the German transitional rule was in breach of the free movement of capital and upheld its decision in the case *Gronfeldt* ([C-436/06](#)) which also dealt with a German transitional rule in 2001. These transitional rules were introduced for the change from the imputation system to the half-income method.

In 2001, the claimant, a German resident GmbH (*Steko*), held shares in various non-resident companies, possibly in EU Member States and in Third States. These shareholdings amounted to less than 10% of the share capital. As the price of these shares had fallen, the claimant conducted write-downs in 2001. However, according to a German transitional rule (sec. 34 par. 4 KStG), write-downs on foreign shareholdings were not deductible in 2001 already (half-income method). In contrast to this, write-downs on domestic shareholdings were still deductible in 2001 (imputation system still applicable). From 2002 onwards, write-downs on foreign and domestic shareholdings are treated equally under the half-income method (not deductible). The question arose whether this different treatment in the year 2001 infringes EC Law.

At first, the ECJ stated that the free movement of capital was applicable and that the transitional rule could discourage residents to maintain its shareholdings in a foreign company. The fact that the different treatment lasted only for one year (2001) would not lead to another conclusion as this may have, nevertheless, significant effects.

The ECJ rejected the argument of the German government that the situation of a foreign shareholding was not objectively comparable with that of a domestic shareholding, as two different taxation systems were applicable. The ECJ stated that precisely these different taxation systems resulted in the different treatment. Therefore this would not be a valid argument. On the contrary, shareholders with domestic as well as foreign holdings would suffer equally from losses by write-downs. The change from the imputation system to the half-income method, which was already applicable for foreign shareholdings in 2001, would not alter these characteristics. The ECJ pointed out that even under the imputation system (before 2001), write-downs on foreign and domestic shareholdings of less than 10% were subject to the same treatment, although foreign shareholdings were not entitled to the same imputation credit as domestic shareholdings were.

The ECJ held that the conditions for the principle of coherence were not met. A potential tax exemption of a subsequent capital gain was not capable of justifying the refusal of an immediate write-down.

Lastly, the ECJ pointed out that the effectiveness of fiscal controls vis-à-vis Third States could not justify the restriction on the free movement of capital if the reason for the write-down was obvious (fall in the stock market).

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Portugal – ECJ referral on Portuguese tax treatment of non-resident taxpayers

In June 2008, the European Commission sent a Reasoned Opinion to Portugal regarding its discriminatory treatment of non-resident taxpayers.

According to the Portuguese General Tax Law (“Lei Geral Tributária”) – Article 19 (4) – non-resident persons, or entities, that do not have a permanent establishment in Portugal, and obtain taxable income within the territory have to appoint a fiscal representative to represent them before the Portuguese Tax Authorities and to guarantee the fulfilment of their fiscal obligations. Similar provisions exist in the Corporate Income Tax and Personal Income Tax Codes. The lack of appointment of a fiscal representative inhibits the non-resident taxpayer from exercising his rights before the Portuguese Tax Authorities.

The Commission considers that this general obligation towards non-resident taxpayers goes beyond what is necessary to guarantee the payment of taxes and prevent tax evasion, thus impeding the free movement of persons and the free movement of capital as established in Articles 18 and 56 EC and Articles 36 and 40 EEA.

The Commission’s Reasoned Opinion is based on the EC Treaty as interpreted by the ECJ in its judgment of 7 September 2006 (Case *N* (C-470/04)). Since Portugal has neither amended its tax law nor responded satisfactorily to the Reasoned Opinion, the Commission decided to take Portugal to the ECJ for its discriminatory treatment of non-resident taxpayers.

The Commission's case reference number is 2006/5036.

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NATIONAL DEVELOPMENTS

Belgium – New regulation for non-resident sportsmen and artists adopted

The Belgian Act Concerning Various Measures was published in the Belgian Official Gazette of 29 December 2008 and is applicable retroactively from 1 January 2008 (assessment year 2009). According to the Belgian tax law, prior to the entry into force of the act concerning various measures, non-resident sportsmen and artists were taxed on their income generated in Belgium via a fixed rate of 18% applied on their income after deduction of lump-sum professional expenses. On the contrary, Belgian resident sportsmen and artists were taxed at a progressive income tax rate with the possibility to deduct their real incurred professional expenses (instead of the lump-sum professional expenses). This could lead to a higher tax burden in the hands of the non-resident sportsmen and artists. The European Commission therefore considered these Belgian provisions as contrary to the EU principle of freedom of services.

Following the request of the Commission of 28 February 2008 to end this discriminatory treatment, Belgium adopted a specific provision aimed at eliminating this discrimination.

According to the new provision, non-resident sportsmen and artists can renounce the use of the fixed rate of 18% and opt to regularise their Belgian professional income obtained in their capacity of sportsman or artist. Subsequently, this professional income will be taxed under the same conditions as applicable to Belgian resident sportsmen and artists. It is important to note that such choice is definitive and irrevocable.

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Belgium – New regulation providing for a tax relief for foreign nursery costs adopted

The Belgian Act Concerning Various Measures was published in the Belgian Official Gazette of 29 December 2008 and is applicable retroactively from 1 January 2008 (assessment year 2009). Prior to the entry into force of the Act Concerning Various Measures, Belgian tax law provided for a tax relief for nursery costs subject to certain specific conditions. More precisely, and amongst other conditions, the nursery costs were deductible in case the nursery was admitted, sponsored, controlled or supervised by a Belgian institution. In practice, nursery costs for children placed in foreign nurseries could thus not benefit from the tax relief. The European Commission therefore considered this tax relief as contrary to the freedom to provide services and the free movement of persons.

Following a request by the Commission of 28 February 2008 to Belgium to end this discriminatory treatment, Belgium extended the scope of application of the existing tax relief so as to eliminate the discrimination.

As from 1 January 2008 (assessment year 2009), nursery costs paid by parents within the European Economic Area (EEA) can benefit from a tax relief to the same extent and subject to the same conditions as nursery costs paid towards Belgian nurseries. In this respect, in order to benefit from the tax relief, the foreign nurseries should be admitted, sponsored, controlled or supervised by a public institution located in a Member State of the EEA.

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Belgium – New regulation providing for tax deductibility of donations to foreign charities

The Belgian Act Concerning Various Measures was published in the Belgian Official Gazette of 29 December 2008 and is applicable retroactively from 1 January 2008 (assessment year 2009). Prior to the entry into force of the Act concerning various measures, donations paid to charities were tax deductible provided certain conditions were met. Amongst others, the given charities should be acknowledged by Royal Decree, which was only possible in case the organisation had legal personality based on Belgian corporate law. In practice, donations paid towards foreign charities were thus not tax deductible.

In its request of 21 December 2006 the European Commission indicates that it considers such provision as contrary to the EU principle of free movement of capital and requests Belgium to end such discrimination.

According to the new provision of Belgian tax law, following the entry into force of the above-mentioned Act, foreign charities located within the European Economic Area can receive similar acknowledgement as Belgian charities. Subsequently and provided all other conditions are met, donations to these acknowledged foreign charities are tax deductible in Belgium.

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Finland – Amendments to legislation on withholding tax on Finnish source dividends since 1 January 2009

The Finnish withholding tax legislation on Finnish source dividends was amended to comply with the requirements set by the EC Treaty in the light of recent ECJ case law. New provisions are applied to dividends paid on or after 1 January 2009. The key amendment is that a non-resident company receiving Finnish source dividend should not suffer withholding tax (WHT) in Finland if the same dividend distributed to a comparable Finnish resident entity would be tax exempt. The amendments have been described in more detail in Newsletter 2008 – 006.

It has been unclear whether the amended rules meet the requirements of the EC Treaty with respect to non-Finnish investment funds and non-profit organizations. Under the wording of the amended provisions, a foreign investment fund and/or non-profit organisation could be liable to Finnish WHT on Finnish source dividend whereas a Finnish investment fund and/or non-profit organization would be tax exempt. The Finance Committee of the Finnish Parliament noticed this unclarity and stated that the starting point of the amended legislation is similar treatment in similar situations. The Committee, however, states that the matter is to some extent still open and refers to the pending Case [C-303/07 \(Aberdeen\)](#) which concerns the comparability of a Luxembourg SICAV and a Finnish limited liability company (taxable entity) or a Finnish investment fund (tax exempt entity).

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France – Supreme Court decision on the compatibility of withholding tax due by EU pension funds on French dividends

In a decision dated 13 February 2009, the Supreme Administrative Court ruled that the tax treatment of French dividends received by French pension funds under domestic tax law should be extended to EU non-profit organisations of the same nature.

According to the French Tax Code and the Administrative guidelines, French pension funds (“*Caisse de Retraite et de Prévoyance*”) are considered as non-profit organizations for tax purposes, and are therefore exempt on dividends received from French companies.

Four Dutch pension funds have asked to nullify French Statements of Practice issued in 2005 which refused to exempt Dutch pension funds from withholding tax on French source dividends.

The Supreme Court stated firstly that this withholding tax is in breach of the EC free movement of capital where EU pension funds are able to show that they are in a similar situation as French "*Caisse de Retraite et de Prévoyance*". It is noticeable that the French Court referred explicitly to the ECJ's *Stauffer* case ([C-386/04](#)) in its recital.

The Supreme Court continued by noting that this discrimination is not justified, as the French tax authorities did not bring any valid arguments (nor the need to preserve the coherence of the tax system, neither to efficiency of tax audit). Thus, the Supreme Court annulled the above-mentioned Statements of Practice.

It should be noted that the same Dutch pension funds have pending cases before the French Supreme Court on the tax levy that applies in France to EU pension funds on capital gains arising from the disposal of French real estate companies' shares.

This ruling brings crucial arguments to pending litigation in France and may open new opportunities for claims. It also supports the complaints that PricewaterhouseCoopers, together with the European Federation for Retirement Pensions, submitted to the Commission in 2005, in which they claimed that dividend distributions to EU pension funds must not be subject to a less favourable tax treatment than dividend distributions to domestic pension funds. See also EUDTG Newsalert [NA 2009-002](#).

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Germany – Supreme Fiscal Court decision on lump-sum taxation of so called 'black investment funds'

On 18 November 2008, the Supreme Fiscal Court (BFH) ruled that domestic shareholders in foreign non-registered investment funds may not be subjected to lump-sum taxation.

The former Foreign Investment Act (FIA), which has been replaced by the Investment Tax Act as of 1 January 2004, distinguished between foreign investment funds which comply with the detailed notification and publication requirements set by the FIA (commonly called 'white investment funds'), funds which choose to reveal relevant information by other means and assign a representative resident in Germany ('grey investment funds'), and funds which decline cooperation altogether ('black investment funds').

Qualification as a black investment fund caused domestic shareholders to be taxed on deemed proceeds without the possibility of demonstrating their actual investment profits. Deemed proceeds were calculated based on the difference between share redemption prices in a particular calendar year, with a minimum amount of 10% of the last redemption price in that year. Also, upon actual sale of shares in the foreign fund, 20% of the sales price was treated

as taxable profit. Shareholders in domestic investment funds were, however, taxed on actual profits.

In its decision that concerns an investment fund situated in Luxembourg which in 1993 and 1994 neither had disclosed relevant information nor provided for a local representative, the Supreme Fiscal Court found that these rules clearly restrict the freedom of capital movement (now Article 56 Sec. 1 EC). The fictitious tax base would make investments in foreign investment funds less attractive for domestic investors, and foreign investment funds seeking investors from the German capital market were put in a disadvantageous position.

Discussing a possible justification under Article 58 EC, the Court held that domestic and foreign investment funds are still in a comparable situation when they fail to comply with their declaration obligations. In both cases the tax authority must determine the taxable investment income, which, as the Court conceded, can be more onerous in the case of foreign funds. Nevertheless, as in the domestic situation the tax authorities could estimate taxable investment profits for foreign funds too. To this end, the authorities could request administrative assistance from a Member State based on the Council Directive on mutual assistance in the field of direct taxation (77/799/EEC).

The Court thus held that lump-sum taxation cannot be justified by tax supervision or tax evasion arguments. Without the possibility to have actual profits considered and given the potentially excessive flat tax effect, it further held the lump-sum taxation rules not to be proportional. As the Court regarded the EC Law situation to be unambiguous it refrained from a referral to the ECJ based on the C.I.L.F.I.T.-decision (C-283/81).

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Germany – Federal Finance Court decision on exit taxation in case of cross-border movements of individuals with shareholdings

A German resident owned more than 50% of the share capital of two German resident corporations. In 2004 the individual moved to Portugal and sold the shares in 2005. In a first step, due to the actual disposal, the increase in value at the time of the movement was taxed in Germany according to sec. 6 AStG. Secondly, the disposal was taxed in Portugal. Portugal determined the taxable capital gain by subtracting the original costs of the shares. The double tax treaty between Germany and Portugal did not foresee, unlike some other German treaties, a step-up in value at the time of the movement. Therefore, one part of the capital gain was taxed twice. The individual appealed against the German tax assessment notice and claimed for a suspension of execution on two grounds: (1) juridical double taxation, (2) retroactive application of the amended sec. 6 AStG in years previous to 2006. The rule which was in force at the time of the movement (2004) was clearly in breach of EC Law as it did not defer the exit tax payment until the shares were actually disposed of. Therefore, the claimant thought that the whole rule was not applicable. However, this rule was amended in 2006 (now it foresees such a deferral) and is also applicable in years previous to 2006. Therefore, the movement in 2004 falls within its scope and was taxable.

On 23 September 2008, the Federal Finance Court judged on the suspension only. The matter itself is still pending. The suspension of execution has to be granted when the assessment notice could seriously be doubted to be lawful. The interim ruling indicates the actual attitude of the Federal Finance Court regarding the compliance of German exit taxation with EC Law.

In contrast with the preceding judgment of the Lower Finance Court of Munich (see [EU Tax News 004-2008](#)), the Federal Finance Court has no serious doubts that the deferred exit taxation of sec. 6 AStG was in line with EC Law. The Court is of the opinion that the juridical double taxation was a result of the territoriality principle as well as the allocation of taxing rights which were accepted by the ECJ. The avoidance of a double taxation, in this case due to the missing step-up in value in Portugal, should be a matter for Portugal not Germany.

Furthermore the Court stated that the retroactive application of the amended exit taxation rule in previous years was neither in breach of German Constitutional Law nor EC Law. According to the Court, the individual moving had no legitimate expectation that the former rule was not applicable because of its incompatibility with EC Law. On the contrary, the taxpayer could have expected that the rule would be amended retroactively. In addition, the Court pointed out that the retroactive application of the amended rule in previous years should be in line with the principle of effectiveness and therefore enforces EC Law.

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Germany – Provision regarding charitable activities when conducted abroad amended

As a reaction to the ECJ decisions on the *Stauffer* case ([C-386/04](#)) and the *Persche* case ([C-318/07](#)), the provisions defining the conditions under which foundations are recognised as having charitable status have been amended as of 1 January 2009. In the *Stauffer* case, the ECJ ruled that foreign charities will be entitled to the same tax benefits as domestic charities if they fulfil special national requirements. In the *Persche* case, the ECJ held that donations to foreign charities were deductible if the foreign charity fulfils the same national requirements as imposed on domestic charities. One of these conditions is to promote the interests of the general public. As the term *general public* was not limited to Germans or the German territory, these conditions could easily be met with the effect that donations to foreign charities are deductible and that foreign charities are entitled to the same tax benefits as domestic charities are. In order to limit the impact of the ECJ decisions, the German legislator introduced an additional condition which has to be met: In case the charitable activity is conducted abroad, it is now required that either the person promoted is resident in Germany or the activity of the charity itself is capable of enforcing the reputation of Germany. According to the German legislator, this additional condition would be in line with EC Law, as the ECJ stated in the *Stauffer* case and the *Persche* case that Member States are free to define what kind of interests of the general public they wish to promote.

In our view, this additional requirement of promoting only German residents or the German reputation could be doubted to be in accordance with the fundamental freedoms. The above mentioned statement of the ECJ should not be interpreted in a way that Member States are free to restrict other nations and nationals. On the contrary, in both cases the ECJ pointed out that the discretion to define the conditions must be exercised in accordance with EC Law.

Although the Member States are free to determine for which charitable purpose they are willing to grant a tax advantage (e.g. research and development, art and culture), this determination has to be valid for foreign as well as for domestic activities. The territorial condition is not justifiable with the argument that only activities with a link to Germany are capable of absolving the State of some of its responsibilities and therefore benefit from tax advantages. It is settled case law that the reduction of tax revenues cannot justify restrictions.

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Italy – Proposed amendment in respect of withholding tax on outbound dividends paid out to EU/EEA foreign pension funds

The Italian Parliament is currently discussing a draft of law (so-called “Legge comunitaria 2008”) which provides for the amendment of the tax treatment of the Italian dividends paid out to EU/EEA foreign pension funds.

More precisely, the above mentioned law proposal provides for the application of a 11% withholding tax (instead of the “ordinary” 27% withholding tax) on dividends distributed to foreign pension funds which have been set-up in accordance with the legislation of another EU Member State or of a EEA (European Economic Area) State included in a “white list” (to be approved by Ministerial Decree yet).

The aim of the above mentioned law proposal is to guarantee the same tax treatment of Italian source dividends paid out to EU/EEA pension funds compared to that provided for the Italian dividends paid out to pension funds resident for tax purposes in Italy.

In fact, Italian pension funds are subject to 11% substitute tax on the annual net operating result (i.e. the difference between the value of the pension fund’s assets at the beginning of the fiscal year and the value of the same assets at the end of the fiscal year) which includes the dividends distributed by Italian companies. Therefore, the levy on such dividends is at maximum equal to 11% of their gross amount.

The need to guarantee the same tax treatment arises from the infringement procedure opened by the European Commission against Italy, on the basis of which on 26 June 2008 the Reasoned Opinion C(2006)4094 was issued, for the discriminatory taxation of dividends paid out to foreign pension funds. The Commission pointed out the existence of a heavier taxation of such dividends compared to those paid out to Italian tax resident pension funds, considering, therefore, the Italian legislation to be in breach of the principles of the freedom of establishment and the free movement of capital (Articles 43 and 56 of the EC).

However, even if approved, the law proposal in question does not completely remove the incompatibility of the Italian tax law on outbound dividends paid out to foreign pension funds. In fact, it has to be pointed out that the heavier taxation of such dividends is due, besides the tax-rate, to the following factors:

- deductibility of expenses: foreign pension funds cannot deduct the expenses suffered on the received dividends, while the same expenses can be deducted by an Italian pension fund; and
- tax due date: dividends paid out to foreign pension funds are subject to taxation at the date of payment while dividends paid out to an Italian pension fund are subject to tax at the end of the fiscal year.

The draft of the law has to be approved by the two Chambers of the Parliament and then published in the Italian Official Gazette before entering into force.

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Netherlands – Dutch Tax Authorities reimburse Dutch dividend withholding tax to EU based pension funds

In January 2009, the Dutch Tax Authorities (DTA) decided to start processing refund claims filed in the Netherlands by EU based pension funds regarding withholding tax levied on outbound dividends. Depending on the actual situation, claimants will either be informed that their claim has been accepted and that they will be reimbursed, or they will receive a request for additional information or a rejection. The DTA will look closely at whether the claims were filed in a timely and correct manner and whether the foreign pension fund can be considered to be equivalent to a pension fund in the Netherlands.

Prior to 1 January 2007, dividends paid by companies residing in the Netherlands for tax purposes were subject to withholding tax at a rate of 25%. Dutch pension funds and charities were entitled to a refund of the tax withheld on dividends received from companies residing in the Netherlands. However, foreign investors such as pension funds based in the EU and EEA countries were not entitled to a refund of the tax withheld on dividends received from companies residing in the Netherlands until the law was changed on 1 January 2007 (except for Liechtenstein). The DTA have now decided to agree on the principle that EU based pension funds should be entitled to a refund of withholding taxes provided they have made appropriate claims within the relevant time limits.

The Netherlands is the second EU Member State after Austria which is ready to take this step in the field of pension funds involving the repayment of hundreds of millions of Euros. Norway and Finland have already taken this step in relation to UCITS funds. The trend set by these 4 countries is very promising for similar requests for refunds filed by foreign investors in other European countries (see also the recent developments in [France](#) and [Spain](#) elsewhere in this Newsletter).

The decision to reimburse Dutch dividend withholding tax to EU based pension funds was triggered by the combined pressure from the European Commission, recent case law from the ECJ and decisions by the Dutch Supreme Court, which have all concluded that the detrimental tax treatment of foreign investors is unacceptable. In particular, the ECJ confirmed in the *Denkavit* case ([C-170/05](#)) the principle that outbound dividends cannot be subject to higher taxation in the source State than domestic dividends. The Dutch Supreme Court followed this decision by the ECJ in case 42 679 in 2007.

At the heart of this process was a study by PricewaterhouseCoopers' [EU Direct Tax Group](#) based on which the European Federation for Retirement Provision ([EFRP](#)) and PwC jointly lodged a complaint with the European Commission in December 2005 against 18 EU Member States, including the Netherlands, for their alleged discriminatory taxation of dividend and interest payments to foreign EU pension funds. The Commission agreed with the analysis of EFRP and PwC and started infringement procedures against the Member States concerned based on Article 226 of the EC Treaty in 2007. The Commission's action against a number of other EU Member States is continuing and is a clear sign that the Commission is convinced that the legislation in the relevant EU Member States is not in line with EC Law.

The decision now taken by the DTA is good news for the European pensions industry and also strengthens the position of claims that have been filed by other investors such as charities, insurance companies and investment companies although each situation has its own specifics. See also EUDTG Newsalert [NA 2009-001](#).

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Netherlands – Dutch Supreme Court judgment in the case of Orange European Smallcap Fund NV: a participation in an investment fund cannot be qualified as a 'direct investment'

On 9 January 2009, the Dutch Supreme Court (*Hoge Raad*) ruled in a case regarding the free movement of capital. This case concerns Orange European Smallcap Fund NV (OEFNS), a Dutch resident portfolio investment fund. Its shareholders reside in various (EU and non-EU) countries. OEFNS receives dividends from various countries, including Portugal and Germany. These dividends have been subject to foreign dividend withholding tax, for which OESF claimed a (substitute) credit. This credit was, pursuant to Dutch legislation, restricted in two ways. Firstly, no credit of DWT was granted with regard to the dividends from Portugal and Germany, on the basis of the non-existence (1997) of tax treaties between the Netherlands and those countries providing for a right to a credit of foreign dividend withholding tax against Dutch income tax. Secondly, with regard to the dividends from other foreign countries, the credit of DWT was reduced in proportion to the participation in OESF by shareholders not residing in the Netherlands. OESF claimed a full credit of all foreign dividend withholding tax.

The *Hoge Raad* has confirmed the preliminary ruling of the ECJ and rules that the decision of the regional court of appeal of Amsterdam (Gerechtshof Amsterdam) can't be upheld.

The reasoning is as follows. Firstly, the objective of the special tax regime is to make dividends received by a shareholder investing directly subject as far as possible to the same treatment for tax purposes as those received by a shareholder investing through the intermediary of a fiscal investment enterprise, so as to prevent investments abroad by such an enterprise from being regarded as less appealing than direct investments. The legislation in question is liable to deter a collective investment enterprise from investing in the Member States in which the taxation of dividends does not give rise to the concession and accordingly constitutes a restriction on the free movement of capital prohibited in principle by Article 56 EC. However, this is justified because it is only as regards investments in the Member States with which a

bilateral tax convention has been concluded that, without the concession granted, the decision to invest through the intermediary of a fiscal investment enterprise runs the risk of being less advantageous to a shareholder who is a natural person than direct investment. Secondly, a reduction of the concession in proportion to the interest held by shareholders resident or established in another Member State creates a restriction on the free movement of capital, which is prohibited in principle to Article 56 EC, in so far as it is liable to impede the raising of capital by a fiscal investment enterprise in Member States other than that in which that enterprise is established, and is also liable to deter investors from those other Member States from acquiring shares in that enterprise. This restriction cannot be justified since such a reduction affects all the shareholders of fiscal investment enterprises without distinction, as it has the effect of reducing the total amount of profit for distribution. The approach in relation to situations in which shareholders of a fiscal investment enterprise are resident or established in another Member State must apply equally to situations in which shareholders of a collective investment enterprise are resident or established in third countries.

Finally, the *Hoge Raad* decided that the participation in an investment fund generally is not aimed at establishing or maintaining lasting and direct links between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity. Therefore, this doesn't fall under the scope of Article 57(1) EC. As a result the tax credit could not be limited in proportion to the participating third country residents.

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Portugal – Draft proposal for the supplementary State budget for 2009

The supplementary State Budget for 2009, submitted for approval to the Parliament on 21 January 2009, foresees the extension of the special tax regime applicable to Portuguese holding companies (SGPS, *Sociedade Gestora de Participações Sociais*), incorporated under the Portuguese law (Tax Benefits Code, *Estatuto dos Benefícios Fiscais* – article 32), to companies incorporated under the law of another EU Member State, whose head office or place of effective management is located in Portugal.

According to the draft proposal, EU companies will benefit from the special tax regime, previously applicable only to SGPS companies incorporated under the Portuguese law, provided that they meet the requirements to which this type of holding companies are subject to, as foreseen in Decree-Law number 495/88 of 30 December 1988.

The main benefits from this special regime are the following: (i) Elimination of double economic taxation on dividends received; (ii) Exemption from taxation of capital gains realised on the transfer of shares held for at least 1 year, if certain requirements are met; and (iii) Financing costs (interest) incurred in the acquisition of the referred shares are not deductible.

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Spain – Amendments expected before end of 2009 regarding the taxation of Spanish dividends paid to EU based pension funds

Even though it has not been announced officially, the Spanish media have said that Spain will amend its domestic legislation in order to end the discriminatory treatment between Spanish pension funds (not subject to tax in Spain) and EU resident pension funds (subject to Spanish withholding tax) before the end of 2009. The retrospective effect of this amendment is not clear at this stage but any pension fund which has already submitted "protective claims" in Spain should be affected in a positive way.

This development is noteworthy given that the Spanish tax rules have not been amended so far in line with the EC Treaty and the EEA Agreement following a Formal Notice and a Reasoned Opinion sent to Spain by the Commission in May 2007 and May 2008, respectively, and the fact that the European Commission announced on 27 November 2008, that it referred the case against Spain to the ECJ. See also: EUDTG Tax News [2009 – nr. 001](#),

-- Ramón Mullerat, José Blasi and Rui Dinis Nascimento, Spain
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Switzerland – Developments in Switzerland

On 13 February 2009, delegations of Switzerland and the European Commission continued their discussion on certain Swiss cantonal measures regarding corporate taxation. The Swiss have presented the corporate reform plans which the government announced in December 2008. As already reported, one part of the reform project will take into account the concerns raised by the European Commission regarding the aforementioned corporate tax provisions. Commission officials however said that, in their view, the proposed modifications to the mixed company and the holding company statuses (albeit not yet developed in detail) may not be sufficient to completely remove the perceived violation of the 1972 free trade agreement (FTA). The Commission considers these company types to be selective in the sense of the EC competition rules and of the state aid doctrine. Nevertheless, the Swiss Government has constantly denied the applicability of the FTA to internal corporate tax matters.

In the last months and especially since the beginning of the year 2009, it has been widely reported by the media that Switzerland has come under increasing pressure from high tax countries such as Germany, France, the United Kingdom and the United States with regard to its exchange of information policy (especially the "banking secrecy"). Since the financial markets surveillance authority and the Swiss government have requested UBS to transmit client data to the IRS, various politicians have heavily criticized the Swiss exchange of information policy and have indicated the possibility of blacklisting Switzerland for its perceived noncooperation in certain fiscal matters. It should be noted, however, that e.g. both the UK and France have ratified or signed amendments to the existing treaties as recently as 12 December 2007 and 12 January 2009, respectively, and neither the UK nor France had insisted on an alteration of the information exchange clause as it stands in the currently applicable versions of the respective tax treaties. See also: EUDTG Tax News [2009 – nr. 001](#),

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

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EU DEVELOPMENTS

Belgium – European Commission requests Belgium to extend the Belgian Notional Interest Deduction regime

On 19 February 2009, the European Commission sent a Letter of Formal Notice to Belgium requesting the Belgian Government to extend its notional interest deduction (“NID”) regime.

Under the NID regime, Belgium has introduced a *sui generis* corporate tax deduction, i.e. Belgian corporate income taxpayers are for tax purposes allowed to claim a NID reflecting the economic cost of the use of capital, equal to the cost of long-term, risk-free financing. In practice, the NID is equal to the multiplication of two factors: the “NID basis” and the “NID rate”. The “NID rate” is determined by making reference to the average interest rate on 10-year Belgian government bonds (i.e. set at 4,473% for financial year 2009). The “NID basis” is determined based on the company’s share capital plus retained earnings as per the last year-end date.

Afterwards, certain adjustments are made (to avoid abuse of the NID or double exemptions): the accounting equity as per the last year-end date is reduced amongst others by the net book value of assets allocated to a PE in treaty countries and by the net book value of real estate located in treaty countries (i.e. where the income is in principle exempted in Belgium based on a double tax treaty).

The Commission considers that these adjustments should not be applied with respect to PEs and real estate located within the EEA as it might otherwise dissuade Belgian companies from carrying on activities and investing in such countries.

The Belgian Minister for Finance has confirmed that in the case where the adjustments detailed above would be recognised as incompatible with the EC Treaty freedoms a solution could be an extension of the NID regime to assets allocated to PE and to real estate in EEA Countries, thereby increasing of as much the NID available to Belgian resident companies and Belgium’s attractiveness. (See also EU DTG Newsalert [NA 2009-003](#)).

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

Czech Republic – European Commission requests the Czech Republic to end discriminatory taxation of non-resident taxpayers

On 19 February 2009, the European Commission formally requested the Czech Republic to end its discriminatory taxation of non-resident taxpayers through a Reasoned Opinion (second step of the infringement procedure provided for in Article 226 of the EC Treaty).

The Reasoned Opinion concerns Czech tax provisions, under which tax on certain types of income of legal persons and individuals resident in another EU Member State or an EEA/EFTA state is assessed on a gross basis, while the tax on the same kind of income earned by Czech

residents is assessed on a net basis as Czech residents may deduct expenses related to this income.

This concerns, in particular, income from rewards and remuneration paid to independent professions, royalties, lease of movable property and from the provision of services, consultancy, advisory, managing, intermediary and other activities.

The Commission is of the opinion that these rules may prevent non-residential taxpayers from providing services or making investments in the Czech Republic and thus restrict the freedom to provide services and the free movement of capital.

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

EU – European Commission publishes survey on the implementation of the Tax Merger Directive EU-wide

On 22 February 2009, the European Commission published a survey on the implementation of Council Directive 90/434/EEC (Merger Directive, as amended). For the publication click [here](#).

NB: page 322, paragraph 1.1 ("Survey of Findings" for Spain), contains an error since Malta is not considered anymore as a "tax haven" as a consequence of the fact that Spain has concluded a Tax Treaty with Malta some time ago which contains an exchange of information clause which is already in force, so Malta is no longer on the blacklist.

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Finland – European Commission requests Finland to end discriminatory taxation of non-resident artists and sportsmen

On 19 February 2009, the European Commission issued a Reasoned Opinion (reference number 2008/2115) in which it requests Finland to amend its national legislation regarding the taxation of non-resident artists and sportsmen. Currently, non-resident artists and sportsmen pay a final tax of 15% on their revenues from Finland. They are only entitled to make certain limited deductions for lodging, transport and daily allowances. Resident artists and sportsmen, however, are taxed at a progressive rate and may deduct the actual expenses linked to their income.

Finland offers extensive deduction rights to persons with unlimited tax liability, who are usually residents, regarding expenses linked to their income. Persons with limited tax liability, usually non-residents, are not entitled to such deductions. The application of different sets of rules to non-resident artists and sportsmen may in some cases lead to heavier taxation compared with the taxation of their resident counterparts. This kind of different treatment could be in breach of the freedom to provide services within the meaning of Articles 49 and 50 of the EC Treaty. The legislation renders the provision of services in Finland less attractive for non-resident artists and sportsmen.

The Commission considers the situations of resident and non-resident taxpayers to be objectively comparable as regards business expenses linked to the artistic or sports activity

which generated the taxable income. Therefore, a difference in treatment would constitute an arbitrary discrimination.

A similar question was considered in the ECJ's judgment in Case [C-520/04](#) (*Turpeinen*) which concerned taxation of a pension paid from Finland to a person residing in another EU Member State. The ECJ considered that Finnish legislation under which non-residents were taxed on the gross amount of the pension at a flat rate of 35%, whereas residents were taxed at progressive rates on the net amount, was discriminatory as it could potentially lead to more burdensome taxation of non-residents. Non-resident pension recipients were considered to be in an objectively comparable situation as resident pension recipients when the pension paid from Finland constituted all or almost all of their income. The proceedings in the *Turpeinen* case resulted in amendment of the Finnish legislation so that all Finnish source pension income is taxed at progressive rates with the same tax allowances and according to the same tax declaration procedure.

Finland has two months to give a satisfactory reply to the reasoned opinion. If no satisfactory reply is given, the Commission may refer the matter to the ECJ.

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Greece – European Commission opens new infringement procedure against Greece for its failure to comply with an ECJ judgment concerning capital duty

Greece applies capital duty when a company transfers its registered office or place of effective management to Greece. However, a general exemption from capital duty is given to maritime companies.

The European Commission considers that these rules are contrary to the Directive concerning indirect taxes on the raising of capital (69/335/EEC Directive) which allows Member States to subject only the formation of companies, not their transfer, to capital duty and which does not allow for the exemption of companies operating in specific economic sectors, such as shipping companies, from the tax.

In 2005, the Commission referred the case to the ECJ, which in its judgment *EC vs. Greece* ([C-178/05](#) of 7 June 2007) declared that "as a result of its legislation relating to the charging of capital duty in the event of transfer of the registered office or the effective centre of management of a company and to the exemption from that duty of co-ownership of vessels, shipping consortia and any form of shipping company, Greece has failed to fulfil its obligations under the Directive".

The Commission has decided to open a new infringement procedure against Greece under Article 228 EC Treaty on the grounds that despite the ECJ judgment, Greece has not communicated any changes to its legislation on charging capital duty in the event of transfer of the registered office or the effective centre of management of a company and to the general exemption from that duty to maritime companies.

If Greece fails to comply with the letter of Formal Notice, the Commission may send a Reasoned Opinion to Greece before bringing the matter to the ECJ for a second time, seeking the imposition of penalty payments.

The Commission's case reference number is 2004/2051

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STATE AID

Germany – European Commission starts in-depth investigation into proposed German capital investment law (Bill to Modernise the General Conditions for Capital Investments - MoRaKG)

On 29 January 2009, the European Commission published a press release stating that there are doubts about the comparability of the German capital investment law with the state aid provisions of the EC Treaty, as they seem to favour certain companies in a selective manner, especially in context with the utilisation of Net Operating Losses.

According to German tax law, after a significant change of ownership, a corporation's Net Operating Loss (NOL) is not deductible anymore. The NOL utilization will be completely denied if more than 50% of the company's shares have been transferred in the last 5 years, or only partially denied if 25% to 50% of the company's shares have been transferred, depending on the amount of shares transferred. These regulations apply to any loss company, regardless of the reasons of the change of ownership.

As an exception, this principle does not apply to cases where both the loss company and the acquiring company meet special criteria according to the capital investment law: The loss company has to meet special size criteria (e.g. equity of less than 20 mill. EURO), the acquiring company as a principal has to be accredited as a venture capital company by a federal German institution. Also non-accredited companies may benefit from this special treatment if they purchase shares of the loss company from an accredited corporation and if the target enterprise meets the size criteria. If these requirements are met, the loss company can use its NOL to the extent of the proportionate increase in gains of the company's domestic assets.

The purpose of this tax advantage was to facilitate access to finance for small and medium sized-enterprises in their early stages of development by attracting investors to capitalize these companies. Such preferential treatment is in line with EC state aid principles in the Articles 87 and 88 EC, as long the regulations are fair and do not give certain companies disproportionate advantages over their competitors.

In its press release, the Commission expresses doubts whether the planned measures comply with the EU guidelines on risk capital investments in small and medium sized-enterprises, especially as the definition of target enterprises does not exclude the provision of risk capital to large enterprises and to firms in difficulty.

The Commission's second area of concern is that the acquisition by a venture capital company does not lead to a loss forfeiture with the target company, whereas the acquisition by other companies does.

Thirdly, to benefit from the advantages, venture capital companies have to have their legal domicile (Sitz) and corporate management in Germany, which excludes certain foreign investment companies. This may be in breach of Article 43 of the EC Treaty on the freedom of establishment.

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Italy – Tax Authorities issue new tax codes for the recovery of State aid granted to utilities with a majority public capital holding, Constitutional Court confirms the recovery is justified

As reported in EU Tax News [2009 – nr. 001](#), with the Decree Law Nr. 185 of 29 November 2008 the Italian government adopted new law provisions in order to recover the tax advantages granted in the form of exemption from the corporate income taxes to the Italian utilities with a majority public capital holding.

The new law provisions have been adopted as a consequence of the European Commission's Decision Nr. 2003/193/EC of 5 June 2002, by means of which the Commission had declared that the tax advantages in question constitute a State aid, under the meaning of Article 87 of the EC Treaty, incompatible with the common market and, therefore, had to be recovered.

These provisions granted to the Italian Tax Authorities the power to recover the aid pursuant to the ordinary assessment and liquidation procedures laid down in the Italian tax legislation with reference to direct income taxes.

Based on them, on 18 February 2009, the Italian Tax Authorities issued the Resolution Nr. 45/E, by means of which they issued new tax codes in order to allow the beneficiaries to actually pay back the aid.

In addition, on 6 February 2009, the Constitutional Court issued a decision declaring that the previous law measures which were adopted by Italy in order to implement the European Commission's decision (i.e. those laid down in Law Nr. 62 of 18 April 2005 and Decree Law Nr. 10 of 15 February 2007) based on the Italian Constitution, in particular:

- Article 117 providing for that the Italian legislation have to be in compliance with the EU Law (therefore, with a European Commission's decision too);

- Article 3 establishing the principle of guarantee of an equal economic position of the tax-payers and, therefore, the removal of the economic effects unlawfully granted to some of them.

In addition, the Constitutional Court held that these provisions are not in breach of the following Articles of the Constitution:

- Article 53 providing for the principle of “ability to pay”, as the law measures at hand recover an aid illegally granted and do not impose additional taxes;
- Article 97 establishing the principle of “impartiality and good functioning of the Public Administration”.

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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/eudirectax.

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