

TAXeNEWS Europe



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ECJ CASES

Belgium – ECJ judgment on Flemish (Belgian) inheritance tax: Eckelkamp case (C-11/07)

On 11 September 2008, the ECJ ruled that the Flemish inheritance tax rules on the inheritance of immovable property are in breach of the the free movement of capital (Article 56 EC).

According to the Flemish inheritance tax rules, an immovable property situated in Belgium inherited from a non-resident is subject to transfer duties computed on the value of that property without taking into account any debt relating thereto, whereas when inherited from Belgian residents the debts relating to the property reduce the taxable basis.

The ECJ found that such rules restrict the free movement of capital as they reduce the value of an inheritance from non-residents compared to Belgian residents.

According to the ECJ, the restriction could neither be justified by the argument that the situation of a resident and a non-resident were not comparable, nor by overriding reasons in the general interest.

As it is only in respect of the deduction of debts from the inheritance that residents and non-residents are treated differently, whereas both residents and non-residents are subject to tax on a basis which is directly linked to the value of the immovable property, the ECJ considered the situation of non-residents and residents is objectively comparable.

The ECJ denied the argument that the rules are aimed to prevent “double deduction” of the debts in both in the residence country of the testator and in Belgium and reaffirmed its prior statement as set forth in the *Amurta* case (C-379/05): a Member State cannot rely on the existence of a tax advantage granted unilaterally by another Member State in order to escape its obligations under the EC Treaty (see also *Arens-Sikken*, same day, C-43/07). The ECJ did not, however, answer the question whether this would be different in case of a tax credit on the basis of a tax treaty.

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Belgium – ECJ referral on Belgian anti-abuse provision concerning abnormal and gratuitous benefits: Société de Gestion Industrielle case (C-311/08)

On 14 July 2008, the Court of First Instance of Mons filed a request for a preliminary ruling to the ECJ in the case of *Société de Gestion Industrielle* (SGI) regarding the compatibility of a Belgian anti-abuse provision with respect to abnormal and gratuitous benefits (hereafter “AGB”) granted by a Belgian resident company.

From a Belgian tax perspective, an AGB occurs when a transaction does not fulfil the at arm’s length principles. The “benefit” notion relates to enrichment without any compensation. The

benefit is “abnormal” when it is contrary to usual habits and is “gratuitous” when it does not constitute the implementation of a duty or has been granted without any compensation.

According to Article 26 of the Belgian Income Tax Code, AGB granted by a Belgian resident company to a related company are added to its taxable basis unless it can be demonstrated that these abnormal or gratuitous benefits are already included in the taxable basis of the beneficiary. In addition, this provision mentions amongst others that irrespective of the foregoing, the advantages must always be added back to the taxable basis of the grantor if the directly or indirectly related beneficiary is a non-resident.

In the present case, where SGI had granted an AGB to a non-resident related company, the Court of First Instance requested a preliminary ruling from the ECJ to clarify whether this Belgian anti-abuse provision is precluded by the basic EU principles of non-discrimination (Article 12 EC), freedom of establishment (Article 43 EC) and free movement of capital (Article 56 EC), in so far as it provides for the taxation of a company resident in Belgium on an AGB granted to a non-resident related company, whereas the AGB would not have been taxed if the related company were a resident.

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Belgium – ECJ referral on Belgian taxation of inbound dividends: Commission vs. Belgium case (C-307/08)

The ECJ recently published the reference for the case referred by the European Commission against Belgium for its discriminatory taxation of dividends received by Belgian private investors from foreign companies ([C-307/08](#)).

The Commission announced on 22 January 2007 that it had decided to refer Belgium to the ECJ for its discriminatory taxation of inbound dividends, which according to the Commission restricts the free movement of capital and/or the freedom of establishment provided for in the EC Treaty and the corresponding provisions of the EEA Agreement (please see: [EU DTG Tax News 2007 - nr 002](#)).

As indicated in its announcement, Belgian private investors receiving domestic dividends either pay a final tax withheld by the company or they are taxed at a special income rate of, in principle, 25%. Inbound dividends are first subject to a withholding tax of up to 15% in the source State on the basis of the double taxation agreement between Belgium and that State, and then suffer Belgian income tax at the special income rate of 25% without getting a credit for the foreign tax. The result is that inbound dividends are taxed more heavily than domestic dividends.

The higher tax burden is a restriction in the sense of Article 56 EC. In so far as the shareholding gives the shareholder control over the company it is also a restriction of the freedom of establishment of Article 43. The same holds for the corresponding articles of the EEA Agreement.

According to the Commission, the EC Treaty obliges the Member State to apply the same system that they use to avoid double taxation on domestic dividends to inbound dividends. In this respect, attention should be paid to the judgement of the ECJ in the case *Kerckhaert-Morres* ([C-513/04](#)), where the ECJ considered that the higher tax burden was compatible with the EU fundamental freedoms. We wonder whether the ECJ will adhere to its prior standpoint in *Kerckhaert-Morres* taking into account the fact that in that specific case a French tax credit was available which actually mitigated the adverse consequences of the potential discrimination generated by the Belgian tax law.

Finally, it should be noted that a similar case regarding the taxation of inbound dividends involving Belgium is also pending before the ECJ (Damseaux; [C-128/08](#)).

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Belgium – AG Opinion on Belgian withholding tax on interest payments to non-resident companies: Truck Center case ([C-282/07](#))

Further to a referral by the Court of Appeal of Liège, AG Kokott delivered her opinion on 18 September 2008 in the case “Truck Center” regarding the compatibility with the freedom of establishment of the distinction the Belgian income tax legislation tax law makes between interest payments to non-resident companies (subject to withholding tax) and interest payments to resident companies (exempt from withholding tax).

The Belgian income tax legislation provides for a withholding tax exemption on Belgian sourced interest paid to Belgian resident companies. That exemption, however, is not linked to any Belgian corporate income tax exemption. In other words, even though a withholding tax exemption is granted to Belgian companies, the interest income is still subject to Belgian corporate income tax in their hands. The Belgian companies are taxed through their assessment notice after having filed an income tax return.

This withholding tax exemption does however not apply to interest paid to non-Belgian resident companies (not having a Belgian establishment). In such a case, the withholding tax suffered constitutes the final tax in the hands of the foreign companies.

According to the AG: Articles 52 and 58 EC do not preclude a national withholding tax on interest payments to non-resident companies, in the case where similar interest payments to resident companies, although not subject to any withholding tax, are taxed at least to the same extent at the level of the corporate income tax of the beneficiaries.

The main arguments having lead to the opinion of the AG are summarised as follows:

First of all, resident and non-resident companies would not be in a comparable situation with respect to the collection of taxes. The source State has much less recovery power on non-

residents than on Belgian residents and this difference could justify differences in treatment. (Note that the Directive 2001/44/EC had not yet entered into force at that time.)

Then, following *Kerckhaert-Morres* ([C-513/04](#)), the AG considers that the review of the potential discrimination should be limited to the Belgian internal tax law. The higher taxation of the interest from Belgian sources resulting from the taxation in Belgium as well as in the State of residence of the foreign beneficiary (in the present case, Luxembourg) being in her view, the sole result of the exercise in parallel by two Member States of their fiscal sovereignty (even if a double tax treaty has been concluded between Belgium and Luxembourg).

The AG then compares the Belgian nominal tax rates and the tax bases applicable. A withholding tax rate of 15% for non-residents cannot be considered as disadvantageous in comparison with a Belgian corporate income tax rate varying from 28% to 39% for residents. As regards the tax base, in particular the deduction of operating expenses (although not at issue in the referral), the AG seems to consider implicitly that the non-deduction of the operating expenses in the source State in the hands of the non-resident companies is in accordance with the principle of the “fiscal symmetry” as these operating expenses will in principle be deductible in their State of residence.

Finally, the AG deals with the question of the pre-financing of taxes. Although withholding taxes are in principle retained upon payment of the interest, which could lead to a potential disadvantage for the foreign companies in terms of cash-flow, the AG nonetheless considers that, given the Belgian companies also have to pre-finance their income taxes, the cash-flow disadvantages that may be suffered in the hands of foreign companies would be remote, if any, and in any event neutralized by the administrative simplification such withholding tax at source generates.

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France – AG Opinion on the French tax group regime: *Société Papillon* case ([C-418/07](#))

On 4 September 2008, AG Kokott published her opinion on the questions whether the provision in the French tax code, which states that a French parent company may not include in its group for tax purposes a French lower-tier subsidiary held directly by a subsidiary established in another EU Member State, whereas it may include in its group for tax purposes that lower-tier subsidiary held by a subsidiary established in France, constitutes a restriction of the freedom of establishment (Article 43 EC).

The AG opinion follows upon a request for a preliminary ruling made on 12 September 2007 by the French Administrative Supreme Court. *Société Papillon* had attempted to include in its group for tax purposes a French lower-tier subsidiary held by a Dutch subsidiary. It was denied to do so by the French tax authorities.

In her opinion, the AG considers that the French provision is indeed a restriction on the freedom of establishment principle, but that it may be justified by the need to preserve the

coherence of the French tax group system. As regards the concept of fiscal coherence, the AG referred to AG Maduro's Opinion in *Marks & Spencer (C-446/03)*: the function performed by fiscal coherence is the protection of the integrity of the national tax systems provided that it does not impede the integration of those systems within the context of the internal market. In the case of the French tax group provision, AG Kokott accepted the justification given by the French tax authorities, stating that the restriction is a means of avoiding a double loss deduction (on the one hand a deduction of a loss at the level of the sub-tier subsidiary and on the other hand deduction of a provision for impairment at the level of the parent).

However, the AG, insisting on the need for proportionality, said it is for the national court to examine whether there is a less restrictive means to deny inclusion of a sub-tier subsidiary for tax group purposes.

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Germany – AG Opinion on deduction of donations to foreign charities: Persche case ([C-318/07](#))

On 14 October 2008, AG Mengozzi published his Opinion in the Persche case, where the ECJ has to decide whether or not the German tax legislation concerning the deductibility of donations for income tax purposes is in line with the principle of free movement of capital. The German resident Hein Persche donated everyday consumer goods to a value of 18.180 EURO 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. The German Federal Tax Court asked the ECJ whether this case is subject to the principle of free movement of capital and if a restriction could be justified.

In his Opinion, the AG states that as long as there is a cross-border donation the principle of free movement of capital applies, regardless of the facts that the donation was made in everyday consumer goods and that the donor by his endowment didn't make a capital investment. By denying the deductibility of donations to foreign entities, the German legislation constitutes a restriction on the movement of capital, since the donation to a foreign beneficiary becomes less favourable compared to a German beneficiary.

As one possible justification, the German Government argued that a foreign recipient of the donation is not in the same situation as a domestic recipient. According to the principle of symmetry, the tax relief is being granted to German entities since they perform duties to German society that otherwise would have been carried out by and at the expense of German authorities. As the Portuguese entity does not bring any such benefit, no tax relief can be granted for the donor. The AG ruled out that argument stating that the ECJ in its decision in the case *Centro di Musicologia Walter Stauffer (C-386/04)*; see also EUDTG [Newsletter 2006 - 006](#)) already decided that according to German tax law the general public not only consists of German citizens but also includes foreign populations. As a consequence, in order to decide

whether the German and the Portuguese charities are in a comparable situation, it is irrelevant if the German society has a benefit from the charity's activities.

Assuming that foreign and domestic charities are in a comparable position, the AG considers the government's argument that the limitation of deductibility of donations might be justified by the need to ensure the effectiveness of fiscal supervision. In contrast to a purely domestic case, national tax authorities in cross-border cases cannot verify the evidence about the statutes and actual management of the respective foreign charity by carrying-out tax audits abroad. At the same time, assigning this task to the respective Member State's tax authorities would cause a disproportionate effort for those authorities. However the AG argues that this point cannot serve as a justification for a complete denial of deductions to charities which are acknowledged in the other Member State. Instead he proposes that as long as the donor himself provides the documents needed, the donations should be deductible, since an absolute impossibility of being allowed to provide relevant information would be equally disproportionate to the objective of ensuring fiscal supervision.

If sufficient information cannot be provided by the donor, in order to ensure that the free movement of capital is respected in practice, the authorities in the Member State should attempt to obtain such evidence using the EU's Mutual Assistance Directive 77/799/EEC.

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Germany – ECJ judgment on German rules on evaluation of participations in domestic and foreign partnerships: Heinrich Bauer Verlag Beteiligungs GmbH case (C-360/06)

In 1988, Heinrich Bauer Verlag Beteiligungs GmbH (HB) was a limited partner in the Spanish partnership Bauer Ediciones Sociedad en Comandita (Ediciones) and held 100% of Basar Zeitungs- und Verlagsgesellschaft GmbH & Co KG (Basar) in Austria.

In order to evaluate unlisted shares in a company for wealth tax purposes under former German tax law, holdings of such companies in foreign partnerships were set at market value which included future earnings, whereas holdings in domestic partnerships were based on the net asset value. This method led to different results which had a direct impact on the amount of wealth tax liability, depending on whether the holding is domestic or foreign.

HB brought an action against the tax authority's decision before the Tax Court of Hamburg, claiming that only the net asset value of the foreign partnerships should have been taken into consideration. The Tax Court referred the case to the ECJ and asked if it is compatible with the freedom of establishment to set a lower value to participations in domestic partnerships than in partnerships in other Member States.

The tax authority's argument that there is no discrimination against foreign investments, since future earnings would also be recognized in domestic cases, was dismissed by the ECJ in the preliminary observations. The Court thereby noted that it is not for the ECJ to rule on the interpretation of provisions of national law.

Regarding Basar, the ECJ decided that neither the freedom of establishment of the EC Treaty nor the corresponding provisions of the EEA Agreement were applicable in 1988, since Austria has been a member of the European Union only since 1 January 1995 and the EEA Agreement did not enter into force until 1 January 1994.

As far as Ediciones is concerned, the ECJ came to the conclusion that the German legislation could create a restriction of the freedom of establishment, provided that HB had a definite influence on Ediciones's decisions. This will be for the referring court to determine. Leaving the question of influence aside, the ECJ argued that HB might be discouraged from acquiring a foreign partnership, since the valuation of the holding in a partnership established in another Member State is less favourable in respect of wealth tax than if that partnership had been established in Germany.

Assuming that HB does have a definite influence on Ediciones' activities, the ECJ analysed if this restriction could be justified. The ECJ ruled out the argument of coherence of the tax system, since it was not shown in what respect there is a direct link between the tax advantage of a holding in a German partnership and a corresponding tax levy. The argument of practical administrative difficulties in calculating the value of holdings in other Member States can also not justify the restriction, since tax authorities could either seek mutual assistance from their foreign counterparts relying on Directive 77/799/EEC or request the taxpayers concerned to provide the evidence that the tax authorities consider necessary to carry out a calculation of the value of the foreign holdings.

Finally, the ECJ by reason of a precaution explicitly stated that the free movement of capital was not applicable in the year of the case (1988), as Directive 88/361/EEC was not yet in force.

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Germany – ECJ judgment on the deductibility of foreign PE losses: Krankenhaus-Ruhsitz case ([C-157/07](#))

The plaintiff, a German resident company, had a permanent establishment (PE) in Austria incurring losses from commercial activity from 1982 onwards (2.5 m DEM). From 1991 until 1994 the PE generated profits (1.2 m DEM). According to the applicable Austrian-German Double Tax Treaty (DTT), the PE's income was only subject to tax in Austria and tax exempt in Germany. Nevertheless, the former German Income Tax Act allowed until 1998 (different from the *Lidl Belgium* case in 1999, [C-414/06](#); see also EUDTG Newsalert [NA 2008-014](#)) a deduction of foreign PE losses (here 2.5 m DEM) with a subsequent recapture to the extent that the PE generated profits in the future (here 1.2 m DEM). However, this recapture was not applicable if the PE losses could **generally** not be deducted in the Source State. Austria, on the other hand, provided for a loss carry forward, but only under the condition and to the extent that Austrian PE losses exceeded the positive worldwide income of the foreign head office in the respective years, irrespective of whether these losses were finally deducted in the Home

State. In the case at hand, the worldwide income of the head office exceeded the losses of the Austrian PE, so that Austria denied a loss carry forward and therefore a loss deduction in 1994. In the view of the German tax authorities and the Federal Finance Court, the Austrian rule was a *specific* one that did not meet the prerequisites of a *general* denial of loss deduction. Therefore, the recapture rule was applied from 1991 until 1994. Thus, the plaintiff could deduct its PE losses of about 1.2 m DEM neither in Austria nor in Germany. Moreover, in Austria the whole losses of 2.5 m DEM were not deductible. Eventually, in 1994 the plaintiff sold the PE with the effect that the remaining losses were final. The Federal Finance Court referred the case to the ECJ asking whether under Art. 31 EEA (freedom of establishment), applicable since 1994, Germany was obliged to take the remaining losses into account by waiving the recapture.

On 23 October 2008, the ECJ decided without an Opinion of the AG. In the ECJ's view, the initial deduction of losses in Germany constituted a tax advantage whereas the subsequent recaptures would undo this advantage. Thus, the provision would result in an unfavourable treatment of cross-border business activities in comparison to a German PE. Nevertheless, the ECJ held that the restriction could be justified by the principle of coherence and the allocation of taxing rights due to a DTT. In the ECJ's opinion, the recapture of previously deducted losses fulfilled the direct, personal and material requirements of coherence as it only recaptured formerly deducted losses and therefore operates in a perfectly symmetrical manner. Furthermore, Germany could not be required to take into account the possible negative results arising from the allocation of taxing rights to another Member State. The ECJ stated that the infringement of the freedom of establishment was only imputable to Austria. Even in the case that the profits and losses made by a PE throughout its existence end with a negative result, Germany was not prevented from applying the recapture mechanism.

In our view, the recapture of losses up to the amount of profits made did not constitute a disadvantage but an equal treatment in comparison to a domestic PE. Only the denial of a loss carry forward in Austria constituted a disadvantage. Therefore, Germany's rule did comply with EC Law, whereas Austria's denial did not. Regarding the deductibility of remaining foreign losses which were not deductible in the Host State, the outcome of this decision may be reconciled with the findings in the *Lidl Belgium* case and the *Marks & Spencer* case ([C-446/03](#)) if one assumes that the plaintiff has possibly chosen the wrong State to claim his fundamental freedoms.

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Italy – ECJ referrals on Italian withholding tax rules on the dividend adjustment: Ferrero e C. Spa case (C-338/08) and General Beverage Europe B.V. case ([C-339/08](#))

The Commissione Tributaria Regionale del Piemonte made two referrals to the ECJ concerning the compatibility of the Italian withholding tax rules on the dividend adjustment (so-called "*maggiorazione di congruaglio*") with the EU Parent-Subsidiary Directive (435/90/EEC).

The “*maggiorazione di conguaglio*”, abolished by the Legislative Decree no. 467 of 1997, was an additional tax that a company had to pay following a dividend distribution in the case that its profits were fully or partially untaxed. Its aim was to offset the tax credit (then in force) granted to the shareholders on the dividends received, in order to avoid undue tax advantages.

This mechanism was applied in the case of dividend distributions to resident and non-resident shareholders. Certain Double Tax Treaties executed by Italy with other Member States provide for the reimbursement of the “*maggiorazione di conguaglio*” paid by the Italian distributing company to the recipient resident in the other contracting State, net of the withholding tax levied on the same amount.

The Italian Tax Court requested the ECJ to answer the following questions.

Whether the withholding tax levied on the dividend adjustment constitutes a withholding tax on profits prohibited under Article 5 of the Parent-Subsidiary Directive (in particular in one of the two referrals it was pointed out that the recipient company requested for the application of the DTT regime); and whether the protective clause referred to in Article 7, paragraph 2, of that Directive applies (in particular in one of the two referrals it was also requested whether the above mentioned article must be interpreted as meaning that the exemption referred to in Article 5 may not be applied in the case that the state of residence of the parent company grants the recipient a tax credit by means of the application of a DTT).

In 2004 the Italian Supreme Court (“Corte di Cassazione”) decided on similar cases stating that the application of the withholding tax on the “*maggiorazione di conguaglio*” did not comply with Article 5 of the Parent-Subsidiary Directive and that the protective clause provided for by Article 7, paragraph 2, of the same Directive could not be invoked.

It is interesting to note that, at that time, the Supreme Court ruled that there was [no need for further clarifications from the ECJ pursuant to Article 234 of the EC Treaty.

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Netherlands – ECJ judgment on Dutch inheritance tax: Arens-Sikken case ([C-43/07](#))

On 11 September 2008, the ECJ ruled that it is contrary to Article 56 EC (free movement of capital) to disallow the deductibility of over endowment debts in respect of the estate of a non-resident deceased person.

Ms Arens-Sikken’s husband died on 8 November 1998. At the time of his death, he was a resident of Italy. As the deceased had made a will, his estate was divided in equal shares between Ms Arens-Sikken and the four children of their marriage. However, as a result of a testamentary parental partition *inter vivos*, all assets and liabilities of the estate passed to Ms Arens-Sikken. As a result of that partition she received an over endowment and assumed an over endowment debt in respect of her children. The estate included immovable property situated in the Netherlands and worth NLG 475,000. Ms Arens-Sikken argued that she should

be assessed for only one fifth of this amount, because she assumed over endowment debts NLG 380,000 vis-à-vis her children. The tax inspector, however, rejected this argument.

Firstly, the ECJ stated that the inheritance constitutes a movement of capital within the meaning of Article 56 EC. Secondly, the ECJ noted that the over endowment debts would have been deductible if the deceased person had remained a resident of the Netherlands. This different treatment constitutes a restriction on free movement of capital. After all, if the overall inheritance tax burden with respect to the immovable property is borne by one heir alone instead of being shared between all the heirs, that overall burden would be higher due to the progressive nature of the tax system.

The ECJ rejected the Dutch Government's position that the difference in treatment is justified on the ground that it concerns situations which are not objectively comparable. By treating the inheritances of both categories of persons in the same way (except for the deduction of over endowment debts) for the purposes of taxing their inheritance, the national legislature has in fact admitted that there is no objective difference between them.

Finally, the ECJ rejected the view that the analysis could be altered by a unilateral tax credit for the avoidance of double taxation in the Member State of residence of the deceased person.

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Netherlands – ECJ judgment on Dutch refusal of taking into account negative rental income relating to immovable property located in another Member State: Renneberg case (C-527/06)

On 18 October 2008, the ECJ handed down its judgment in respect of the preliminary ruling which was requested by the Dutch Supreme Court (*Hoge Raad*). The case concerns Mr Renneberg, who transferred his residence from the Netherlands to Belgium during December 1993. In the years 1996 and 1997, he resided in a house in Belgium which he acquired during 1993 and financed with a mortgage loan from a Dutch bank. During these last two years, Mr Renneberg received his entire income in the Netherlands. With regard to the Belgian dwelling, the applicant suffered a negative rental income which was not accepted as a deductible item from Mr Renneberg's Dutch taxable income by the competent tax authorities.

On appeal, the Supreme Court decided to stay the proceedings and refer the following question for a preliminary ruling:

'Must Articles 39 EC and 56 EC be interpreted as precluding, either individually or jointly, a situation in which a taxpayer who, in his [Member State] of residence, has negative income from a dwelling owned and occupied by him, and obtains all of his positive income, specifically work-related income, in a Member State other than that in which he resides, is not permitted by that other Member State ... to deduct the negative Income from his taxable work-related income, even though the [Member] State of employment does allow its own residents to make such a deduction?'

The ECJ considered the situation of a transfer of residence by a national to come within the scope of Article 39 EC, the freedom of movement for workers. The Court also states that the Dutch legislation leads to a less advantageous treatment of non-resident taxpayers compared to resident taxpayers. Despite this differential treatment, the Dutch legislation could nonetheless be in line with the EC Treaty, if there is an objective difference between the two categories of taxpayers.

However, the ECJ stated that a taxpayer such as Mr Renneberg, who derives almost all of his income in the Netherlands and has no significant income in his Member State of residence (Belgium), is in an objectively comparable situation to a resident taxpayer in the Netherlands who is also employed in this Member State for the purpose of taking into account his ability to pay tax. It is not disputed that resident taxpayers *can* deduct negative rental income in the Netherlands, unlike non-resident taxpayers. According to the ECJ, this differential treatment constitutes an obstacle to the freedom of movement for workers, which is in principle prohibited by Article 39 EC.

Moreover, the ECJ emphasises that Mr Renneberg is not able to take the negative rental income into account in his Member State of residence, and that the applicant is therefore deprived of any possibility to deduct the negative income. Given these factual circumstances, as well as the fact that no justifications have been brought forward, the ECJ concludes that the question must be answered positively and that Article 39 EC thus prohibits the Dutch tax authorities from refusing to take into consideration the negative rental income relating to the immovable property located in Belgium.

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Spain – ECJ judgment on Basque corporate tax measures: Unión General de Trabajadores de la Rioja case (joined cases [C-428/06](#) to [C-436/06](#))

The Basque corporate tax regime, which foresees reduced corporate tax rates and other kinds of corporate tax incentives for entities having their tax residence in the Basque Provinces, has been examined in order to clarify if the tax measures within this regime can or cannot be classified as illegal State aid under Article 87 (1) EC as “selective” measures. This examination results from the actions brought by several Spanish entities before the Basque Regional Court, which requested the ECJ for a preliminary ruling.

The ECJ’s judgment of 11 September 2008 follows the criteria established in the *Azores* case ([C-88/03](#)) judgment of 6 September 2006. The ECJ considers that a tax measure adopted by an intra-State body with institutional, procedure and economic autonomy cannot be qualified as a “selective” measure just because the measure is not applicable in all the State. The ECJ considers that the Basque region has institutional, procedural and “in principle” also economic autonomy:

- Institutional autonomy: from a constitutional point of view, the Basque Region has a political and administrative status which is distinct from that of the Central Government.
- Procedural autonomy because its decisions can be adopted without the Central Government being able to intervene directly as regards its content.

The ECJ points out, however, that the Basque Region has economic autonomy (the financial consequence of a reduction of taxes is not offset by aid or subsidies from the central government) only “in principle”. In conclusion, the ECJ says that the Basque Regional Court should first carry out a deep analysis on whether or not the finance system of the Basque region (the so-called “Concierto Económico”) causes any tax advantage approved by the Basque region to be compensated by the Spanish State through the so-called “Cupo” mechanism. The “Cupo” is a complex mechanism involving a calculation based on the Gross National Product of the Basque Region compared with that of the Spanish State as a whole, through which the amount of money is determined which the Basque Region has to pay annually to the Spanish State Treasury for the services rendered by the State for the benefit of the Basque Region.

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NATIONAL DEVELOPMENTS

Denmark – Danish National Tax Tribunal: Different treatment of income under Danish thin capitalisation rules depending on the residence of the debtor

Under Danish law, a company is not taxed on interest income and capital gains if a group related debtor company can not deduct the corresponding interest expense or capital loss due to Danish thin capitalisation rules. The aforementioned rule will not apply if the debtor company is a non-resident in Germany. A court case is pending on the the compatibility of this rule with the freedom of establishment (Article 43 EC).

The case concerns a Danish limited liability company APS. The company group of APS is represented with its own companies in Germany, the Netherlands and Belgium. APS exports 73% of its production to more than 60 countries. Engineering as well as research and development for faucets are concentrated in the Danish division. Production capacity for faucets and bathroom accessories are located in Denmark.

During the years 2004, 2005 and 2006, ASP received interest from its wholly owned German subsidiary. The amounts have been approximately 3.6 m. DKK, 3.9 m. DKK and 5.6 m. DKK respectively (in total 13.1 m. DKK). During the same years, the German subsidiary was thinly capitalized according to German thin capitalisation rules. Consequently, the German subsidiary has not been able to deduct the interest expense to the Danish APS in its own tax returns.

In its tax returns APS treated the interest as non-taxable income because the corresponding interest expense was not deductible in Germany. According to APS, the main argument for this tax treatment is that if the German subsidiary would have been a Danish entity, the interest yield should have been non-taxable.

The Danish tax authorities, however, treated the interest as taxable income as the law did not oblige them to take German thin capitalization rules into account. APS appealed against that decision.

It is APS's opinion that the Danish thin capitalization rule constitutes a violation of the freedom of establishment and the free movement of capital, arguing that the increase of the taxable income equal to the interest from the German subsidiary makes investments by APS to a subsidiary in another EU country more disadvantageous than investments in Danish subsidiaries.

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Finland – Amendments proposed to the legislation on withholding taxation of Finnish source dividends

The Finnish Government has initiated a Bill (113/2008) to amend withholding tax legislation on Finnish source dividends to comply with the requirements set by the EC Treaty in the light of recent ECJ case law. New provisions are to be applied to dividends paid on or after 1 January

2009. The key point of the proposal is that a non-resident company receiving Finnish source dividends should not suffer withholding tax in Finland if the same dividend distributed to a comparable Finnish resident entity would be tax exempt. In order to benefit from tax exempt Finnish source dividend, three requirements must be met:

1. A comparable entity in Finland would not be taxed on the dividend pursuant to Finnish dividend taxation rules.
2. The recipient is resident in an EEA state with which Finland has agreed on mutual assistance and information exchange in direct taxation matters (EU and EEA states excluding Liechtenstein).
3. The dividend beneficiary demonstrates that the Finnish withholding tax is not fully credited in its resident country.

In certain cases, intra-Finnish dividends are only partially tax exempt (75% of the gross dividend taxable at the rate of 26%). Partial exemption applies to dividends received by a non-quoted company from a quoted company when the dividend recipient owns less than 10% of the distributing company and to dividends arising from investment asset shares (relating solely to securities investments made by financial, insurance and pension institutions). Pursuant to the proposal, in equivalent cross-border situations, a non-resident dividend recipient company would be subject to withholding tax levied at a rate of 19.5% (unless a tax treaty provides a lower rate).

The proposal might not meet the requirements of the EC Treaty with respect to non-Finnish investment funds. According to Finnish tax legislation a Finnish investment fund is defined as an entity in the same way as a limited liability company. Further, the specific Finnish rules on dividend taxation provided in the Business Income Tax Act refer to entities in general (i.e. both investment funds and limited liability companies). Pursuant to a special provision in the Finnish Income Tax Act, Finnish investment funds benefit from a general tax exemption. The fact that Finnish investment funds do not pay taxes on dividends received is based on the general tax exemption rule (Income Tax Act) and not on the specific rules on dividend taxation (BITA). As a result, if a Finnish investment fund would be taxed only according to Finnish tax rules on dividends in the Business Income Tax Act, the dividend could be taxable in certain cases as mentioned above. However, taking into account the specific rule on general tax exemption of Finnish investment funds in the Income Tax Act, the fund is not liable to tax even in these cases. According to the Bill, foreign investment funds would pay tax in these cases since their comparable taxation is evaluated only on the basis of dividend taxation rules in the Business Income Tax Act. Consequently, the Bill results in a situation where a foreign investment fund could be liable to Finnish withholding tax on Finnish source dividends whereas a Finnish investment fund would be tax exempt.

The Bill also proposes changes to the taxation of non-resident individuals receiving Finnish source dividends. The aim is to be able to determine the taxable amount of dividends received by a non-resident individual at least in the same way as the taxable amount of dividends received by a Finnish resident individual, i.e. a non-resident individual would not pay more taxes than a Finnish resident individual. Non-resident individuals could choose whether their dividend would be taxed at a 28% withholding tax rate on the gross amount or in accordance

with the Finnish Tax Assessment Act. The requirements for applying the Finnish Tax Assessment Act would be the same as the requirements set for non-resident companies in order to benefit from tax exempt Finnish source dividend (see above).

Further, the Bill lowers the threshold for the application of the EU Parent-Subsidiary Directive from 15% to 10% as from 1 January 2009.

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Finland – Central Tax Board rules that tax neutral exchange of shares is possible between Finnish and Norwegian companies

The Finnish Central Tax Board issued an advance ruling on 1 October 2008 (KVL 55/2008) concerning an exchange of shares between a Finnish and a Norwegian company. The Central Tax Board found the Finnish provisions on tax neutral exchange of shares to be applicable although the recipient company was not resident in an EU Member State.

A Finnish resident entity (A Oy) and a Norwegian entity (B AS) had the intention to carry out a share exchange so that A Oy would give its shares in Finnish C Oy to B AS and receive as consideration newly issued shares in B AS. As a result, B AS would own all the shares in C Oy. The arrangement was comparable to a share exchange referred to in the Finnish Business Income Tax Act and in the EU's Merger Directive (90/434/EEC, 2005/19/EC). However, the provisions on share exchange in BITA are applicable only to companies resident in an EU Member State and, in the case at hand, the recipient company was resident in an EEA country, Norway.

In its ruling, the Central Tax Board stated that taking into consideration the provisions on freedom of establishment in Article 43 EC and Article 31 EEA, the principles of the share exchange provision in the Business Income Tax Act were applicable to the case in question. Thus, the share exchange was not considered as a taxable transfer for A Oy and the acquisition cost of the shares received as consideration was considered to be the undepreciated acquisition cost of the shares exchanged. The advance ruling covers tax years 2008 and 2009.

The decision is not yet legally binding and appeal to the Finnish Supreme Administrative Court is still possible.

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France – Court of Appeal rules that French CFC legislation applicable to French resident individuals is not compatible with EC law

Art 123 bis of the French Tax Code (passed in December 1998) applies to French resident individuals who own directly or indirectly, at least 10% of an entity (such as a corporation, a

fiduciary or similar entities) that is subject to a favourable tax regime, meaning, a company whose tax burden is less than 50% compared to what it would have paid in France, had it been established in France. Whenever Art 123 bis applies, profits of the foreign company are “deemed distributed” and taxed at the level of the French resident individual shareholder.

Mr. Rifaut owned 99.5% of Camelius, a “Société Anonyme” incorporated in Luxembourg. This company was a “1929 Holding” until 1 July 1999, and then became a “SOPARFI”. The FTA did not consider that the freedom of establishment applied on the grounds that the above entity did not carry out a real economic activity, and was set up solely for tax avoidance purposes.

On 22 August 2008, the Nancy Court of Appeal cited the pre-eminence of the EC Treaty over domestic legislation and made references to Article 43 of the EC Treaty, and also by Article 56. It then pointed out that hindrance to those two fundamental freedoms can be justified only in certain limited circumstances.

The Court underlined that by dissuading French resident individuals from establishing an entity in another Member State, or from making investments through such entities, Art 123 bis is a restriction to Article 43 EC and an obstacle to Article 56 EC.

Looking at the “justifications” in relation to the prevention of tax evasion, the Court ruled that Art 123 bis is not specifically designed for wholly artificial arrangement aiming at circumventing French tax law. By generally targeting all situations where a French individual holds more than 10% in an entity enjoying a favourable regime, it creates an irrefutable presumption of tax evasion. As a result, such a provision appears to be disproportionate and incompatible with EC Law.

The Court finally ruled that the management of a portfolio should in principle be considered an economic activity falling within the scope of the freedom of establishment, as this is a stable and continuous contribution to the economic life of a Member States. The fact that Camelius may have been created for the sole purpose of managing M. Rifaut’s portfolio and that, possibly, Camelius had no effective economic activity in Luxembourg - which was not proved by the FTA - had no impact on the case, since, according to the Court, the scope of Art 123 bis goes beyond targeting purely artificial arrangements.

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Germany – Federal Tax Court on asset transfer to EU permanent establishments, I R 77/06

In its judgement of 17 July 2008, published on 8 October 2008, the German Federal Tax Court changed its previous settled case law on the tax treatment of asset transfers to a foreign PE, the income of which is exempt due to a Double Tax Treaty.

A German partnership (claimant) held shares in a US inc. and was also limited partner in an Austrian partnership. The book value of the US inc. shares amounted to approx. DM 687 m. In 1995, the participation in the US inc. was transferred to the Austrian partnership in exchange for shares. The Austrian partnership assigned the participation a value of approx. DM 691 m. The claimant did not treat the difference of ca. DM 4 m as immediately taxable, but made an adjustment item of DM 4 m in the tax return, stating that this profit should only be taxed when the undisclosed reserves were realised (e.g. through disposal).

From an EC law perspective, two points of this decision deserve observation: An asset transfer between two partnerships of the same partner is legally a disposal of the assets, however it is possible to carry this out at book value in domestic situations (at that time not by legal statute, but through case law). A tax neutral transfer required that the assets were set at book value in the receiving partnership. The Court held that the fact that the Austrian partnership was not subject to German bookkeeping requirements could not restrict the possibility of a book value transfer. Even though not all foreign receiving partnerships may qualify for this treatment, it at least has to apply to partnerships within the EU, as it would cause a breach of the freedom of establishment if an asset transfer could only be carried out at book value if the receiving partnership is subject to domestic bookkeeping provisions. An immediate taxation of the undisclosed reserves in the assets can also not be justified by the fact that the Austrian partnership is not included in the scope of the Merger Directive 90/434/EEC. The Directive is secondary law and can as such not reduce the scope of the EC Treaty fundamental freedoms.

The attribution of the shares in the US inc. to an Austrian PE (of the AT partnership) does not deprive Germany of the right to tax the undisclosed reserves in these shares upon later disposal. Previously, the Court held that an asset transfer from a domestic head office to a foreign exempt PE amounted to a taxable withdrawal of the asset from the business, since the asset exited the German tax jurisdiction.

The Federal Tax Court has now changed its case law: The asset transfer to a foreign exempt PE does not cause withdrawal of the asset from the business. According to today's view, the exemption of PE profits in the tax treaty does not result in Germany losing its right to tax the asset value increase that occurred in Germany. Hence, the previous case law is outdated. The German taxing right is - even if the foreign PE is exempt - only excluded to the extent that the asset is attributable to the foreign PE and to the extent the realised profits are generated in the PE. Therefore, there was neither (pre 2006, when the treatment of asset transfers to foreign PEs was enacted) a legal basis to tax the asset transfer, nor was there a need for this.

Since a tax neutral asset transfer was in domestic cases only granted where the receiving partnership attributed book value to the asset, the Federal Tax Court took the view that this requirement had to be fulfilled also in a cross border case in order for the transfer to be tax neutral. In the current case, this meant that a gain of ca. DM 4 m was subject to immediate taxation.

The question is now how this view of the Federal Tax Court impacts current law, which explicitly stipulates that there is a taxable withdrawal of assets in cases where Germany's

taxing right in respect of the capital gains from the disposal of, or the utilisation of an asset, is excluded or reduced.

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Germany – Federal Tax Court decision following the ECJ judgment in Schwarz/Gootjes-Schwarz

Based on the ECJ's decision *Schwarz/Gootjes-Schwarz* ([C-76/05](#)), the German Federal Tax Court published its decision regarding the deductibility of fees paid for foreign private schools on 8 October 2008. The German Income Tax Act allows a deduction of 30% of fees paid to private schools in Germany if these fulfil special accreditation criteria according to the German Constitution or State law. In order to become accredited for tax relief purposes, a private school inter alia needs to be located in Germany and must not enhance the segmentation of pupils due to the economic possibilities of their parents.

In the decision *Schwarz/Gootjes-Schwarz*, the ECJ declared the German provision to be in breach of Articles 18 EC and 49 EC based on the fact that it involves a higher tax for taxpayers who send their children to foreign schools compared to those who send them to German schools.

In its decision, the 10th chamber of the Federal Tax Court had to answer the question as to how to reconcile national tax law with the guidelines provided by the judgment of the ECJ. Depending on the interpretation of the precedence of EC Law over national legislation, two alternative routes are possible: On the one hand, a provision that is incompatible with EC Law might not be applied at all. Applied to the case at hand school fees wouldn't be deductible, neither in national nor in cross-border cases. On the other hand, instead of dismissing the whole provision, only the element that is in breach of EC Law could be revoked, maintaining the rest of the provision. This method in practice would lead to a legal position where school fees to foreign schools are deductible as long as the other legal premises are fulfilled.

The 10th chamber of the Federal Tax Court decided to choose the second alternative, not considering the legal doubts about this method expressed by the chairman of the first chamber of the same Court, who claims that in terms of competency, an EC Law-compatible interpretation of a tax provision, which was primary introduced within the framework of social policy, could only be made by the Federal Constitutional Court and not by the Federal Tax Court. Furthermore, the chairman is of the opinion that as a reaction to an ECJ decision, a partial disapplication of such provision is not possible, meaning that in this case only the full refusal of the tax benefit for all taxpayers can serve as a proper reaction on the judgment in the *Schwarz/Gootjes-Schwarz* case.

Regarding the prohibition of segmentation, the Federal Court referred the case back to the lower court in order to verify whether or not the foreign school complies with the required criteria. However, the criterion of prohibition of segmentation is in practice obviously irrelevant

in purely domestic cases, since private schools become accredited even though the amount of school fees to pay causes a segmentation of pupils due to the economic possibilities of their parents. Nevertheless, following the Court's reasoning, this criterion should be referred to in cross-border cases in order to decide about whether or not the foreign school can be accredited. This different treatment might in our view create a new discrimination against foreign schools.

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Greece – Greece amends the taxation of inbound and outbound dividends

Following the referral of Greece to the ECJ by the European Commission regarding the discriminatory taxation of inbound dividends (Commission vs. Greece Case [C-406/07](#)), Greece amended its taxation framework for both inbound and outbound dividends.

According to the previous regime, dividends distributed by Greek companies were exempt from taxation in the hands of the beneficiary irrespective of its legal form, residency or nationality. On the other hand, foreign sourced dividends received by Greek individuals were fully taxable with a credit being provided for the withholding tax on dividends paid abroad.

By virtue of the new tax legislation, from 1 January 2009, a dividend withholding tax of 10% will be imposed on dividends distributed by Greek Sociétés Anonymes (not other forms of companies) to resident or non-resident beneficiaries. Such tax will also apply to dividends deriving from profits of previous fiscal years. No withholding tax will be levied on dividend payments by Greek resident subsidiaries to EU resident parent companies subject to the EU Parent Subsidiary Directive conditions.

Foreign sourced dividends received by individuals will also be subject to 10% final tax from 1 January 2009, with no credit being provided for the tax paid abroad. Although, following the ECJ's decision in the case *Kerckhaert-Morres* ([C-513/04](#)), it is doubtful whether EU implications are expected to arise, the absence of a provision of a credit for the tax paid abroad may be incompatible with the provisions of DTTs for the avoidance of double taxation.

The procedural aspects of the inbound dividends taxation (i.e. persons liable to withhold the tax, applicable procedure, etc.) have not yet been clarified. Interpretative circulars are expected to be issued by the Ministry of Finance in the next weeks.

The reference in the explanatory memorandum of the law that the equal treatment of inbound and outbound dividends is necessary to ensure compliance with EU rules provides for an additional argument for the Greek individuals intending to claim back the tax paid contrary to the EC Treaty with respect to foreign dividends received before 1 January 2009, subject to the Greek prescription rules.

The taxation of inbound dividends received by Greek companies remains unchanged: Greek parent companies (participation of at least 10% as of 1 January 2009) are entitled to credit

both the underlying corporate tax and the dividend withholding tax, if any, that correspond to the dividends distributed both by their direct subsidiary or any other lower-tier foreign subsidiary (irrespective of whether they are within the EU). Greek companies not qualifying as parents are entitled to credit only the dividend withholding tax, if any.

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Netherlands – Supreme Court rules that free movement of capital from and towards third countries is not applicable in case of majority shareholdings

On 26 September 2008, the Dutch Supreme Court (*Hoge Raad*) decided that Article 56 EC is not applicable in third country relations in case of majority shareholdings, even if the object and purpose of the rule at issue covers both minority and majority shareholdings.

The case concerned a taxpayer which held 99,9% of the shares in C Holdings BV, 64.3% of the shares in E AS, incorporated and resident in the Czech Republic and all the shares in F AS, also resident in the Czech Republic (a non-EU country at the time).

With regard to the last two (Czech) participations, the taxpayer incurred *inter alia* interest costs. These costs were excluded from deduction based on the (*old*) Article 13, paragraph 1 of the Dutch Corporate Income Tax Act, whereas they would have been deductible in case of a domestic subsidiary (see case [C-168/01 Bosal Holding](#)).

The Supreme Court has decided that Article 56 EC does not apply to the facts of the case at issue, because the aforementioned costs are related to the financing of participations in which the taxpayer has a controlling influence (majority shareholdings). The Supreme Court states that such non-EU majority shareholdings fall within the scope of the freedom of establishment (Article 43 EC) only, and that an alleged breach of the free movement of capital (Article 56 EC) must be regarded as an inevitable consequence of a breach of the freedom of establishment (referring to e.g. case [C-452/04 Fidium Finanz](#)).

The decision of the Supreme Court is remarkable in the light of case [C-157/05 \(Holböck\)](#) and subsequent case law and opinions (e.g. in case [C-418/07 Papillon](#)). Unfortunately, the Supreme Court did not follow its AG General Wattel who had advised to refer the case to the ECJ.

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Netherlands – Supreme Court rules that ‘most favoured nation treatment’ is not required for tax sparing credits

A NV, a company resident in the Netherlands, has received dividend, interest and royalty payments from its subsidiaries in Member States and third countries. The dividends from these

participations are exempt in the Netherlands. Under the tax treaties with Brazil and Greece, the NV was entitled to a tax sparing credit with respect to (some of) those payments.

The NV argued that EC Law offers the benefit of those (favourable) tax treaties with respect to payments from its subsidiaries from other (Member) States. The NV contended that the Netherlands unlawfully distinguishes between domestic taxpayers with regard to the place where their capital is invested: investments in Brazil and Greece in comparison to investments in other countries. Furthermore, the NV argued that the Netherlands should credit foreign withholding taxes on dividends, because Dutch dividend withholding was also credited or refunded.

Most favoured nation treatment

The Supreme Court held, with reference to the case of *D* ([C-376/03](#)), that Member States are at liberty to conclude tax treaties for the elimination of double taxation. It is beyond any doubt that if a difference in treatment of foreign source income is the result of the limited scope of a bilateral tax treaty, that limited scope is a distinctive circumstance. As a consequence, cases which come within the scope of a tax treaty are not similar to cases which come within the scope of another tax treaty. Therefore, the Supreme Court concluded that no restriction of the freedom of establishment or free movement of capital exists.

Foreign tax credit

With respect to the taxpayer's second argument, the Supreme Court observed that NV is not subject to corporation tax on the foreign dividend because of Dutch legislation (participation exemption). Referring to *Gilly* ([C-336/96](#)) the Supreme Court held that if the Netherlands were required to grant a tax credit for the foreign dividend withholding tax greater than the fraction of its national tax corresponding to the dividend income from abroad, it would have to reduce its tax in respect of the income from other sources. This is not required by EC Law.

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Netherlands – Supreme Court rules that a currency loss on a loan connected to a minority participation in a third country company is deductible under Article 56 EC

On 26 September 2008, the Supreme Court (Hoge Raad) applied the principles of *Deutsche Shell* (case [C-293/06](#)) to the Dutch participation exemption as it stood before 2004. It held that currency losses on a loan which was taken up to acquire a minority shareholding in a third country company should be deductible on the basis of Article 56 EC, notwithstanding the provisions of the Dutch participation exemption system which stated that both currency losses and gains are exempt from corporation tax.

The taxpayer, a BV resident in the Netherlands, owned 12,03% shares in a company established in Czech Republic (not part of the EU in the relevant year). BV incurred a currency loss on a loan which it had taken up to acquire the shares in that company. At that time, the currency loss was not deductible because costs which are related to a participation (a 5%

shareholding or more) were only deductible if they could be linked to taxable profits in the Netherlands.

In case [C-168/01 Bosal Holding](#) the ECJ held that this non-deductibility of costs restricts the freedom of establishment in EU situations. The Supreme Court has now extended this judgment to currency losses on loans. The fact that a currency gain is also exempt is not relevant. In third country situations, the currency loss should be deductible in case of a minority shareholding.

It should be noted that the exemption of the said currency losses and gains was introduced in 1996. As a result, the restriction was not grandfathered by Article 57 EC.

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Netherlands – Dutch Supreme Court announces preliminary question on the effect of optional residency status

On 12 September 2008, the Supreme Court of The Netherlands (Hoge Raad) announced a preliminary question on whether the EC Law obligation towards the equal treatment of resident and non-resident taxpayers can be fulfilled through the existence of an optional regime that allows non-resident taxpayers the choice of being treated as resident taxpayers.

The claimant is a German resident who conducts business through a permanent establishment in The Netherlands. For Dutch tax purposes he qualifies as a non-resident taxpayer. The claimant wishes to make use of a fiscal facility available to both resident and non-resident taxpayers of The Netherlands who spend over 1.225 hours a year on business activities. The calculation method for this time period depends on the residency status of the taxpayer. For resident taxpayers, hours related to all business activities are taken into account irrespective of the location of the business. For non-resident taxpayers, only the hours related to business activities that can be attributed to a business located in The Netherlands are counted.

In the relevant year, the claimant devoted over 1.225 hours to business activities, but less than 1.225 hours on activities related to the Dutch permanent establishment. If the claimant is a resident taxpayer, he could make use of the facility. As claimant is a non-resident taxpayer, he cannot use the facility. The Supreme Court deemed this disadvantageous difference in treatment to be in contravention of Art 43 EC.

The issue is whether this outcome can be justified. Dutch tax law provides an optional regime which allows a non-resident taxpayer the choice of being treated as a resident taxpayer. If the claimant had chosen to be treated as a Dutch resident taxpayer, he could have made use of the facility. As resident taxpayers are taxed on their world wide income, an additional consequence might however have been a financial disadvantage owing to the effects of progressive taxation.

On the one hand, it might be argued that in this situation the claimant suffers no disadvantage because he can choose to be treated as a resident taxpayer. Any additional financial costs which ensue due to progressive tax rates are no greater burden than that placed on resident taxpayers.

On the other hand, it might be held that the position of resident and non-resident taxpayers, who both generate most of their income in their resident state, is different and that the optional residency regime does not adequately address this point. In this view, the optional regime does not suffice as a way of meeting EC Law obligations.

The Supreme Court has formulated the following preliminary question:

“Can a regulation which disadvantages non-resident taxpayers compared to resident taxpayers in the same situation and which therefore contravenes Art 43 EC, nevertheless be in accordance with EC Law because non-resident taxpayers have the option of being treated as resident taxpayers?”

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Portugal – Changes in Portuguese legislation concerning its discriminatory taxation of lottery winnings

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.

According to the Personal Income Tax (PIT) Code, winnings from lotteries, games and gambling paid to individuals by entities with registered office, effective place of management or permanent establishment in Portugal are subject to taxation herein (at a rate of 25% or 35%, depending on the type of lottery). Additionally, winnings paid by foreign lotteries to resident individuals will also be taxed in Portugal, being included in the taxpayer's global income (subject to marginal rates varying from 10.5% and 42%).

However, according to the PIT Code, winnings from *Euromilhões e Liga dos Milhões*, lotteries organized in Portugal by *Santa Casa da Misericórdia de Lisboa*, an entity carrying out activities of social interest, received by resident individuals or non-resident individuals, are not subject to taxation in Portugal. The Commission considers that this exemption provided in the Portuguese legislation violates the EC Treaty, taking into consideration that the referred exemption is not applicable to lottery winnings of other EU entities also carrying on activities of social interest as *Santa Casa da Misericórdia de Lisboa* does. This is considered an infringement of article 49 of the EC Treaty.

Following the Commission request, the Portuguese Government has included in the proposed State Budget for 2009 a change in the PIT Code according to which winnings derived from lottery *Euromilhões* are not subject to taxation in Portugal.

The Commission's case reference number is 2007/2138.

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Portugal – Proposed State Budget for 2009

The proposed State Budget for 2009, amongst other measures, has introduced changes to the personal income tax (PIT) Code, allowing individuals resident in other EU Member States or in a EEA (in a country with which there is reciprocity of tax information), that 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 with the tax rates that would have been applied if they were resident individuals. This rule will also be applicable for Corporate Income Tax purposes, concerning companies resident in other EU Member States or in the EEA that render certain type of services in Portugal.

Furthermore, a new rule has been introduced 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).

Concerning Corporate Income Tax, the State Budget for 2009 has also introduced relevant changes, such as a limitation on the application of the reduced withholding tax rate on interest and royalties, foreseen in the EU Interest & Royalty Directive, in cases where the beneficiary of the income is owned, directly or indirectly, by an entity resident for tax purposes in a third country. In such circumstances, the beneficiary of the income should prove that the structure was not implemented with the main purpose of benefiting from the reduced tax rates foreseen in the Directive. Additionally, in case of payment of interest and / or royalties to associated enterprises resident in other EU countries, the reduced withholding tax rate foreseen in the Directive will only be applicable up to the amount of royalties / interest that would have been paid in case the transaction was concluded between independent parties.

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UK – Changes proposed to "late paid interest rule", currently in breach of EC Treaty

In general, UK legislation currently allows relief for interest expense on an accruals basis, whether due to a UK or non-UK recipient. However, in the case of certain non-UK recipients, if the interest is not paid within 12 months of the year-end then relief is not due until the interest is actually paid. This is commonly known as the "late paid interest rule".

A number of parties have complained that in the case of EU or EEA recipients, this rule is not consistent with the EC Treaty. The UK authorities have therefore issued a consultation document proposing two alternatives:

- Option A - Extend the late paid interest rule to UK recipients.
- Option B - Remove the late paid interest rule, but replace it with anti-avoidance measures to deny relief where payment is delayed in order to obtain a tax advantage.

No details have been given for transitional provisions to cover interest accrued before the changes but paid afterwards.

The intention appears to be to introduce the changes in Finance Bill 2009 and draft legislation is expected shortly. However, the authorities have also informally confirmed that taxpayers can choose to disregard the late paid interest rule for returns submitted after the date of the consultation but before the legislation is changed, and for earlier returns where these are still subject to any open enquiry. This concession and any final changes will apply to all interest recipients, whether within the EU or EEA or not.

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EU DEVELOPMENTS

Estonia – European Commission requests Estonia to amend discriminatory taxation of pensions paid to non-residents

On 16 October 2008, the European Commission sent a formal request to Estonia to amend its discriminatory rules regarding the pensions paid to non-residents. The request takes the form of a Reasoned Opinion (second step of the infringement procedure provided in Article 226 of the EC Treaty).

The infringement procedure concerns the situation where the non-resident person receiving less than 75% of its taxable income from Estonia, is not able to benefit from the personal deductions available to residents.

According to the Estonian Income Tax Law, the annual personal allowance is EEK 27,000. In addition, if a resident individual receives pensions under the law or obligatory pension scheme of Estonia or EEA country or under social security agreement, the pension is subject to an additional annual allowance of EEK 36,000. Personal allowances are granted to the residents of the other EU Member States only on the conditions that they have received at least 75% of their taxable income from Estonian sources and they file a tax return in Estonia.

The Commission is of the opinion that in case of non-resident pensioners with a modest income, Estonia cannot assume that the Member State of residence is in a position to take account of the taxpayer's personal circumstances and should therefore also make the personal deductions in Estonia available to such non-resident taxpayers.

The Commission considers that the restrictive application of personal allowances in the Estonian legislation constitutes a discrimination prohibited by Article 39 of the EC Treaty concerning the free movement of workers, as the favourable treatment is not open to non-resident taxpayers who are effectively in the same situation as resident pensioners.

Making the personal allowances subject to the "75% rule" only whereas not taking into account the applicability of personal deductions in the state of residence, is likely to be considered contrary to the Article 39 of the EC Treaty. If no deductions are provided under the law of state of residence of the taxpayer, the person will be subject in Estonia to a more burdensome situation compared to a resident taxpayer.

It is currently unclear whether the Estonian Government will propose any immediate changes to the income tax law in this respect or decide to go to the court.

The outcome of the case may impact other EU Members State that have similarly to Estonia based the wording of their legislation directly on the Commission's Recommendation of 21 December 1993 on taxation of certain items of income received by non-residents (94/79/EC).

If there is no satisfactory reaction to the Reasoned Opinion within two months, the Commission may decide to refer the matter to the ECJ.

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

Ireland – European Commission requests Ireland to amend its discriminatory tax provisions in relation to the taxation of Savings Certificates and certain Government, State-Issued and State-Guaranteed Securities

Irish tax legislation provides for a tax exemption for interest on Savings Certificates issued by the Irish Minister of Finance. Furthermore, Irish legislation provides a tax exemption to non-resident persons and persons resident in Ireland for less than three years in respect of interest from certain Government, State-Issued and State-Guaranteed Securities. Similar foreign certificates and securities are not tax exempt.

The European Commission has sent Ireland a formal request to amend these provisions on the grounds that they discriminate against taxpayers who wish to invest in similar financial instruments issued in other Member States or in EEA countries. The rationale for this request is that these provisions may have the effect of dissuading taxpayers from investing in such instruments by denying tax exemption for any associated interest income.

The ECJ ruled in Case C-478/98, *Commission vs. Belgium*, judgment of 26 September 2000, that any measure taken by a Member State which is liable to dissuade its residents from making investments in other Member States constitutes a restriction on free movement of capital within the meaning of Article 56 of the EC Treaty.

Accordingly, the Commission considers that these exemptions are incompatible with the free movement of capital, as guaranteed by Article 56 of the EC Treaty and Article 40 of the EEA agreement.

This request is in the form of a Reasoned Opinion, the second stage of the infringement procedure under Article 226 of the Treaty. If Ireland does not amend its law within two months, the Commission may refer the case to the ECJ.

The Commission's cases reference number is 2007/2061

-- Anne Harvey, Ireland; anne.harvey@ie.pwc.com

Greece – European Commission requests Greece to amend its discriminatory tax provisions applicable to the acquisition of a first residential real estate in Greece

Greek tax legislation provides for an exemption of real estate transfer tax in case of acquisition of a first residence of a surface area up to 200 m² or of a plot of land, to which a residence of a surface area up to 200 m² can be built and on condition that the real estate will not be

disposed within the next five years of its acquisition. Eligible persons are Greek residents and under certain conditions Greek nationals residing abroad.

The European Commission has sent Greece a formal request to amend these rules which give permanent residents in Greece a tax exemption on the real estate transfer tax for their first residential property purchase, but do not grant the same exemption to first-time residential buyers who do not yet live permanently in Greece but intend to do so in the future.

Furthermore, Greece has been requested to abolish its discriminatory rules that, under certain circumstances, allow a real estate transfer tax exemption to Greek nationals living abroad when they are acquiring their first residential real estate in Greece, but do not allow the same exemption to foreign nationals.

The Commission considers that the exemptions provided in the Greek legislation constitute a violation of the free movement of persons and the freedom of establishment laid down both in the EC Treaty and in the EEA Agreement.

The Commission is of the opinion that Greece may accord more advantageous tax treatment to persons living permanently in Greece and purchasing their first real estate there, compared to those who merely acquire such real estate for investment purposes. This difference in treatment may be justified by promoting acquisition of housing and preventing or at least impeding speculations. However, the same treatment must be granted to all first-time residential buyers who intend to live in the property, whether they are already permanently living in Greece at the time of purchase or not.

On the other hand, the Commission considers that Greece discriminates against non-residents who are not Greek nationals in comparison with non-resident Greek nationals insofar as only the latter are, under certain circumstances, exempt from paying real estate transfer tax in Greece when acquiring a first real estate there.

This request is in the form of a Reasoned Opinion, the second stage of the infringement procedure under Article 226 of the Treaty. If Greece does not amend its law within two months, the Commission may refer the case to the ECJ.

The Commission's case reference number is 2007/4319.

-- Vassilios Vizas and Stavroula Marousaki, Greece; alexandros.sakipis@gr.pwc.com

Portugal – European Commission requests Portugal to end discriminatory taxation of foreign services providers

In January 2007 the European Commission sent a formal request to Portugal to amend its tax legislation concerning taxation of services rendered in Portugal by non-resident entities

According to the law in force, non-resident service providers are subject to a final withholding tax applicable to the gross amount of their income (at a rate of 15%), whereas domestic providers will be taxed only on their net profits, i.e. after deduction of related costs (at a rate of 25%) .

The withholding tax may be avoided by application of article 7 of the Double Tax Treaty (DTT) concluded between Portugal and other Member States, as long as some formal requirements are met (namely to obtain a specific form, 21-RFI, duly certified by the tax authorities of the country of residence of the beneficiary of the income). The only EU Member State with which Portugal has not concluded a DTT is Cyprus. Accordingly, the Commission considers that the higher taxation of service providers resident in Cyprus restricts the freedom to provide services discouraging entities resident in Cyprus from rendering services in Portugal. It seems that the Commission considers that a DTT eliminates the discriminatory tax treatment of entities in other EU Member States. However, certain service providers may not be protected by a DTT, such as for example partnerships.

Since Portugal has neither amended its tax law nor responded satisfactorily to the reasoned opinion regarding this matter, the Commission decided to take Portugal to the ECJ for its discriminatory tax treatment of non-Portuguese service providers.

Following the above, the Portuguese Government has included in the proposed State Budget for 2009, among others, a change in the Corporate Income Tax Code according to which companies resident in other EU Member States or in the EEA that render certain type of services in Portugal will be allowed to request the reimbursement, total or partial, of the withholding tax levied on the income derived from Portugal, in the same conditions and according to the tax rates that would have been applied if they were resident entities.

The Commission's case reference number is 2005/4153.

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

Spain – European Commission requests Spain to change discriminatory taxation of non-resident individuals and restrictive exit taxes

On 16 October 2008, the European Commission issued press releases concerning infringement procedures against Spain regarding, respectively, the discriminatory taxation of non-residents and an exit tax imposed on individuals who cease to be tax residents in Spain.

Non-residents operating in Spain without a permanent establishment (PE) are taxed on their gross income, i.e., without deduction of costs, whereas Spanish residents are taxed on their net income. The Commission holds that these rules contravene the free movement of persons and workers, the freedom to provide services and the free movement of capital set forth under the EC Treaty.

On the other hand, the Commission formally requested Spain to change its tax provisions which impose an exit tax on individuals who cease to be tax residents in Spain.

Where an individual transfers his residence abroad, it should include any unallocated income (i.e. income pending to be taxed) in his tax return for the last tax year in which he is still considered a resident taxpayer and will be taxed on such income immediately.

This is not in line with the general rule which sets forth that income should be taxed in the calendar year in which it is received. The Commission holds that these rules are likely to discourage individuals from exercising their right of free movement 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 opinions and change these rules within two months, the Commission may decide to refer the matter to the ECJ.

-- Ramón Mullerat, José Blasi and Rui Dinis Nascimento, Spain;

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Sweden – European Commission requests Sweden to amend its restrictive company exit charge tax rules

If a Swedish company ceases to be taxable in Sweden this will – according to the internal Swedish tax legislation – lead to the imposition of an immediate exit charge.

On 24 April 2008, the Swedish Supreme Administrative Court ruled in a case involving a Swedish company moving its place of effective management and control from Sweden to Malta and becoming tax resident there (under the tie-breaker rule of the Swedish-Maltese tax treaty). Because all income came from real estate in the UK, the company would not be liable to tax in Sweden anymore. Under Swedish rules this would trigger an immediate exit charge.

The Supreme Administrative Court, however, ruled that it would contravene the freedom of establishment within the European Union to impose an exit charge. The court stated that the exit charge was a disproportionate measure and thus could not be allowed.

On 18 September 2008, in line with the court's ruling, 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, takes the view that this immediate exit charge contravenes the freedom of establishment.

Sweden has two months to respond to the Commission and if no satisfactory response arrives from Sweden, the Commission may decide to refer the case to the ECJ.

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

UK – European Commission calls on UK to implement ECJ's Marks and Spencer decision on cross-border loss relief

The European Commission has formally requested the UK to properly implement the ECJ's decision in the *Marks & Spencer* cross-border loss relief case ([C-446/03](#)). The ECJ ruled that UK legislation denying relief for non-UK losses was incompatible with the freedom of establishment and that such relief should be allowed where there is no possibility of obtaining relief in the other state.

The UK legislation was subsequently amended, but with certain restrictions which in practice make it virtually impossible to obtain the relief. For example, conditions include:

A very wide interpretation of when there is a theoretical possibility of using the losses in the other state, however unlikely that may be in practice.

Determination of whether the above condition is met immediately after the accounting period, not at a later date such as when the claim is made. For example, where a company is liquidated after the year-end but before the return is filed, the condition would not be met and the losses could not be claimed.

Application to losses incurred after 1 April 2006, not earlier.

Following a number of complaints, the EC has issued a reasoned opinion under Article 226 of the EC Treaty, requiring the UK to respond satisfactorily within two months or risk referral back to the ECJ.

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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.

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