

# TAXeNEWS Europe



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## ECJ CASES

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

On 29 September 2008, the Austrian Fiscal Court of Appeal referred questions for a preliminary ruling to the ECJ on the compatibility with EU Law of the Austrian tax treatment of inbound portfolio dividends (see also [EU Tax News 2009 – nr. 002](#)).

Since that time the relevant tax provision was amended as part of a tax reform in 2009 (“Budgetbegleitgesetz 2009”). The participation exemption for dividends was expanded to EU portfolio dividends provided that *i.a.* mutual assistance has been agreed with the state of origin. In October 2009, the ECJ requested a written statement from the Austrian Fiscal Court of Appeal on whether the amendments of legislation have consequences for the preliminary ruling questions. The Austrian Fiscal Court of Appeal adjusted the questions as follows:

1. Is it in line with EU Law that the tax exemption for portfolio dividends from EEA-countries is subject to the condition of the existence of a mutual assistance agreement whilst exemption of dividends from substantial holdings (also for non-EEA dividends) as well as a tax credit for substantial holdings (in cases of switch-over from tax exemption to the credit method) do not require a mutual assistance agreement to be in place?
2. Does a domestic regulation for EU/EEA inbound portfolio dividends requiring the shareholder to fulfill certain formal conditions so to be able to apply the exemption method comply with EU Law, even though in practice the conditions for the application of the exemption method (documentation of comparable foreign taxation, foreign tax rate) cannot or only hardly be fulfilled by the shareholder?
3. Does a domestic regulation for EU/EEA inbound portfolio dividends providing – under certain circumstances – for a switch-over from the exemption method to the credit method comply with EU Law, even though in practice the conditions for the application of the credit method (documentation of foreign tax paid) cannot or can only hardly be fulfilled by the shareholder?
4. Does a tax exemption for non-EU/EEA inbound dividends claiming a minimum holding of 10% whilst dividend income from domestic holdings is tax exempted irrespective of the size of the holding comply with EU Law?
5. If the answer to question 4 is in the negative, can conformity with EU Law be achieved by application of the tax credit method (instead of exemption method) even though the conditions for obtaining the credit of foreign corporate income tax practically cannot or can only hardly be fulfilled by the shareholder?
6. Provided conformity with EU Law of dividends from non-EU/EEA countries can only be achieved by application of the exemption method (question 5), is it in line with EU Law that, because of the absence of a mutual assistance agreement, tax exemption of portfolio

dividends is denied whilst dividends from substantial holdings are tax exempted irrespective of mutual assistance?

7. Provided relief from double taxation of inbound dividends can be achieved via application of the tax credit method, does EU Law require Austria to refund or to allow carry forward of the foreign source tax if the taxable income does not suffice to credit (part of) the foreign source tax?

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### **Germany – New ECJ referral on special personal deductions of non-residents**

On 14 October 2009, the lower Finance Court of Niedersachsen referred a new question to the ECJ: Does it comply with EU Law if expenses in the form of a perpetual annuity cannot be deducted from the rental income tax base of non-residents?

The claimant, a German national who works and resides in Belgium, was granted a rental house located in Germany by way of anticipated succession from his mother who he had to pay a perpetual annuity for in turn. In his German tax return he declared the rental income as well as his expenses for the annuity. However, the tax authority denied the deduction of the annuity as this is technically not considered to be an income related expense but a personal related expense, which can be offset by German residents only (Sec. 50 para. 1 sentence 4 ITA in connection with Sec. 10 No. 1a ITA (2002)).

The Finance Court has doubts whether this denial is in line with Art. 56 EC and refers to the ECJ decisions in the cases *Schumacker* (C-279/93) and *Conijn* (C-346/04). Although it follows from consistent case law of the ECJ that personal related expenses of non-residents don't have to be considered in the source state - except the person who derives most of his income in the source state - the court is of the view that this treatment is not applicable for expenses which are, in fact, related to income and which would be deductible for residents.

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**Italy – ECJ judgment on Italian withholding tax on outbound dividends: Commission v. Italy case ([C-540/07](#))**

On 19 November 2009, the ECJ ruled that the Italian withholding tax applying to dividends paid out by an Italian tax resident company to a company tax resident in another EU Member State or EEA country is incompatible with the EC Treaty and EEA Agreement.

Pursuant to the Italian tax legislation in force until 31 December 2007, such outbound dividends, except those within the scope of Directive 90/435/EEC (Parent-Subsidiary Directive), were subject to a 27% withholding tax, or a reduced rate in the case a DTT between Italy and the EU/EEA State of residence applied. By contrast, dividends paid out by an Italian tax resident company to another Italian tax resident company (“domestic dividends”) were only taxed on 5% of their gross amount at the 33% tax rate then in force.

The ECJ confirmed AG Kokott’s opinion ([see EU Tax News 2006 - nr. 005](#)) and stated that the Italian tax rules on dividends paid to EU companies constitute a restriction of the free movement of capital which - considering the applicability of EU Directive 77/779/EEC concerning the mutual assistance by the competent authorities of the Member States - cannot be justified.

Regarding dividends paid to companies resident in the EEA, the ECJ stated that although the Italian legislation constitutes a restriction of the free movement of capital, the restriction is justified by the overriding reason in the public interest to combat tax evasion.

In its defence, Italy had argued that no provision for the exchange of information exists between Italy and Liechtenstein and that the bilateral conventions for the avoidance of double taxation in force with Iceland and Norway do not contain any provisions laying down an obligation to supply information. It is noteworthy that the Commission did not rebut Italy on this point.

In our opinion the ECJ judgment, on the one hand, strengthens the position of EU companies which have already submitted claims for the reimbursement of the Italian withholding tax declared in breach of the EC Treaty and should encourage other EU companies to quickly submit refund claims in Italy. On the other hand, the judgment may provide arguments to the Italian tax authorities to deny the refund claims submitted by EEA or Third Country resident companies if the relevant conventions for the avoidance of double taxation do not contain provisions that guarantee an actual exchange of information. See also EUDTG [Newsalert 2009 – nr 029](#).

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## Netherlands – AG opinion on Dutch fiscal unity regime: X-Holding case ([C-337/08](#))

On 19 November 2009, AG Kokott's opinion in the case of X-Holding was published. X-Holding is represented by PricewaterhouseCoopers in the Netherlands. The AG holds the view that the impossibility to form a cross-border Dutch fiscal unity is not in breach of Art 43 EC (freedom of establishment).

Under the Dutch fiscal unity regime, a Dutch parent company can form a fiscal unity with a Dutch subsidiary company. This allows *inter alia* for the consolidation of profits and losses within the fiscal unity, for tax-neutral restructuring and transfer of assets between the companies in the fiscal unity and for the submission of one single tax return. It is not possible for a Dutch parent and an EU subsidiary to form a fiscal unity, which means that none of the aforementioned advantages are available in the cross-border situation.

If a Dutch parent company forms a fiscal unity with its subsidiary, the effect for Dutch tax purposes is that the subsidiary is regarded as a permanent establishment (PE) of the parent company. Consequently, in a cross-border situation, the allocation of taxation rights between the Netherlands and the resident Member State of the subsidiary would be guaranteed pursuant to the terms of the applicable tax treaty. X-Holding has, in light of the above, argued that the Dutch fiscal unity regime constitutes a breach of the freedom of establishment.

The AG disagrees with this view on the grounds that there is no requirement for a Member State of origin to accord equal treatment to establishment in a different Member State using respectively a PE or a subsidiary company. She argues that the *mutatis mutandis* application of the rules on the tax treatment of foreign PEs to foreign subsidiaries would have the effect of extending the fiscal jurisdiction of the State of residence of the parent company. She considers that this would jeopardise the allocation of power to impose tax between the Member States, but does not address the point that the allocation of taxation rights is in fact safeguarded by the tax treaty.

The AG further notes that whilst the cross-border transfer of assets between a parent company and its foreign subsidiary may impair the allocation of taxation rights between Member States, national measures aimed at combatting such interference must meet the standards of proportionality. In the case of X-Holding, it is for the national court to investigate whether this criterion has been satisfied, *in absentia* a fiscal unity. See also EUDTG [Newsalert 2009 – nr 027](#).

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## NATIONAL DEVELOPMENTS

### **Belgium – Discrimination against foreign investment funds: parliamentary question further to the Aberdeen case**

In the wake of the ECJ's judgment in the Aberdeen case case ([C-303/07](#)) dating from 18 June 2009, the following question was raised in the Belgian parliament to the Belgian Government:

*“In the Aberdeen case the ECJ found against Finland regarding discrimination in Finnish law. A foreign fund – a Luxembourg SICAV – that invested there in a Finnish undertaking was liable for tax at source on dividends, whereas Finnish funds qualified for an exemption in this regard. Belgium would have similar laws. Furthermore, contrary to numerous other European countries, Belgium has not yet amended its legislation. Hence, it ought to reimburse hundreds of millions to foreign open-ended investment companies and contractual investment funds. 1) Is this information true? 2) If so, what is the situation with the required statutory amendments? 3) Have claims been filed in this regard?”*

On 25 November 2009, the Belgian Government published its reply, which is unsatisfactory.

First, according to the government, Belgian SICAVs would also suffer a Belgian withholding tax on Belgian sourced dividends *“so that it could be said that Belgian and foreign SICAV are treated identically under Belgian laws”* for withholding tax purposes. This explanation is obviously incomplete. Indeed, the Belgian withholding tax is, by its nature, a mere advance tax payment on the Belgian income tax of the beneficiary, and as regards Belgian SICAVs, it is actually refunded to the latter given the fact that the dividends received by them are tax exempted;

Secondly, the government argues that foreign SICAVs, forming part of the category of “non-resident savers”, would benefit from a *“special exemption from Belgian withholding tax”*. This answer is inaccurate. A foreign SICAV, being considered as operating a business or carrying on transactions of a lucrative nature, is not entitled to any exemption of Belgian withholding tax on Belgian sourced dividends (such exemption is in principle available for foreign pension-funds);

Thirdly, the government also considers the reasoning by the ECJ in the Test Claimants in Class IV of the ACT Group Litigation case ([C-374/04](#)):

*“to require the Member State in which the company making the distribution is resident to ensure that profits distributed to a non-resident shareholder are not liable to a series of charges to tax or to economic double taxation, either by exempting those profits from tax at the level of the company making the distribution or by granting the shareholder a tax advantage equal to the tax paid on those profits by the company making the distribution, in fact would mean that that State would be obliged to abandon its right to tax a profit generated through an economic activity undertaken on its territory.”*

Here again, the reasoning of the government is not convincing, because Belgium is not at all obliged to abandon its right to tax a profit generated through an economic activity undertaken on its territory in order to treat foreign investment companies in the same way as Belgian investment companies. Indeed, Belgium has in any case already taxed the economic activity undertaken on its territory by applying the corporate income tax regime to the Belgian distributing company.

Based on the government's reply, foreign investment funds are more than ever strongly urged to file withholding tax claims in Belgium.

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### **Belgium – Parliamentary question on Belgian participation exemption regime: holding of shares in usufruct**

Following the law of 24 December 2002, in order to benefit from the Belgian participation exemption regime, dividends received by a Belgian company should, provided all other conditions are met, relate to shares held in “full ownership” by the receiving Belgian entity. Thus, in case of shares held in usufruct the Belgian participation exemption regime is not applicable.

In this respect, the question was brought before the ECJ whether such condition was compatible with the Parent-Subsidiary Directive, i.e. does the concept of “holding in the capital of a company of another Member State” in Article 3 of the Parent-Subsidiary Directive also include the “holding of shares in usufruct”. In its decision of 22 December 2008, the ECJ considered that the Parent-Subsidiary Directive does not apply to the holding of shares in usufruct. However, the ECJ specified that if a Member State would exempt dividends received from a resident company in relation to such usufruct, the same treatment should be applied in case of dividends received from a company established in another Member State (see [EU Tax News 2009 – nr.001](#), *Les Verger du Vieux Tauves* [C-48/07](#)).

That ECJ judgment resulted in a parliamentary question on the relevance and justification of the condition of “full ownership”, which must be met in order to apply the Belgian participation exemption.

In its reply, the Belgian Minister of Finance stated that the condition of “full ownership” does not preclude the free movement of capital as it applies to both Belgian and foreign dividend income. Moreover, the Minister stresses that, in its judgment, the ECJ confirmed the Belgian concept which precludes holding of shares in usufruct from shares in the capital of a company.

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**Belgium – Parliamentary question on supplementary municipal charge levied only on foreign sourced movable income payments without the intervention of a Belgian financial intermediary**

Belgian individual taxpayers are normally due to declare their taxable income, including movable income (interest, dividends, etc.) in an annual income tax return filed with the Belgian tax authorities. According to Article 313 of the Belgian income tax code (“BITC”) however, said taxpayers are not required to mention in their annual tax return the movable income for which Belgian withholding tax has already been retained and paid to the Belgian tax authorities.

In case of foreign source movable income a withholding tax is only retained if a Belgian financial intermediary intervenes in the movable income payment. Otherwise, the exemption provided by Article 313 BITC is not applicable and the Belgian individual taxpayers are required to declare the movable income in their annual tax return.

According to Article 465 BITC, municipal authorities have the right to levy an additional charge on the individual income tax. This additional charge is only levied on the income tax due according to the annual tax return filed by the individuals, and therefore not on the withholding tax suffered.

As a result, municipal charges can in practice be considered only to be levied when foreign source movable income is paid directly to a Belgian individual taxpayer without the intervention of a Belgian financial intermediary. Put in another way, should the individual taxpayer want to avoid the municipal charge, it is necessary that the foreign movable income is paid via the intervention of a Belgian financial intermediary.

In a reply to a parliamentary question in this respect, the Minister of Finance stated that such additional municipal charges, in case of foreign sourced movable income directly paid to the Belgian individual taxpayer, could be justified given the fact that the movable income is only subject to tax generally 2 years after collection. In case of a Belgian sourced movable income received by a Belgian individual taxpayer, the withholding tax is automatically and thus immediately retained upon payment. Indeed, the slight increase in effective tax rate due to the additional municipal charges compensates this cash-flow disadvantage.

In his reply the Minister of Finance also referred to the pending *Dijkman v. Belgische Staat* case ([C-233/09](#)) (see also [EU Tax News 2009 – nr. 005](#)). Moreover, the Minister stated that if such additional municipal charges would appear to be precluding the EU’s fundamental freedoms, then treatment of foreign financial institutions as a Belgian financial intermediary could be investigated.

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## **Estonia – Court of Appeal decision on Estonian withholding tax on outbound dividend payments**

On 25 November 2009, the Tallinn District Court (Court of Appeal) concluded that the withholding tax on outbound dividends is incompatible with the EC Treaty.

In the case at hand, an investment fund (UCITS) established under Luxembourg law as a legal entity, owned shares in an Estonian resident corporation and received dividends in 2004 and 2005. Dividends distributed to a non-resident having less than 20% participation in an Estonian legal entity were subject to a withholding tax. The fund claimed that the situation where tax was withheld from dividends paid to a foreign investment fund was in violation of Articles 56 and 58 EC because there was no tax withheld from dividends paid to a domestic UCITS.

As in Estonia UCITS can only be established as a contractual fund, and the Luxembourg UCITS was a legal entity, the dispute relates to whether the foreign fund established as a legal entity should be compared to an Estonian fund established as a (non-taxable) contractual fund (i.e. pool of assets) or to a (taxable) Estonian legal entity. Previously, the Court of First Instance found that the comparison should be made purely on the legal status of the entity and found that no incompatibility with EC Treaty exists. The Court of Appeal, however, found that the comparison based on the economic functions the funds are performing should be taken as the basis to determine whether the free movement of capital is violated or not. Taking such comparison as the basis, the District Court found indeed that there was different treatment.

In respect of justifications, the court analysed whether the restriction on the free movement of capital can be justified by the necessity to safeguard the cohesion of the tax system and the division of taxing rights between the Member States. Interestingly, here the court also found it necessary to determine how the unit holders are taxed in Estonia. It found that a difference in timing of taxation could only be justified by the cohesion of the tax system and would as such be proportionate. However, the court found that if investments by non-residents to an Estonian company are made through an Estonian UCITS, such income is to be taxed neither at the level of Estonian fund nor at the level of the non-resident unit holders. At the same time, investments made by Luxembourg UCITS would be subject to a withholding tax. The court concluded that such more burdensome taxation of a fund of another Member State cannot be justified by the necessity to safeguard the cohesion of the tax system and the division of taxing rights between the Member States.

The Court of Appeal did not find any justifications and concluded that the withholding tax on outbound dividends is incompatible with EC Treaty. The case has now been appealed by the tax authorities at the Supreme Court.

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## **Finland – Amended legislation on the taxation of non-resident artists and sportsmen**

On 19 February 2009, the European Commission issued a Reasoned Opinion (reference number 2008/2115) requesting Finland to amend its legislation regarding the taxation of non-resident artists and sportsmen. At that time, non-resident artists and sportsmen paid a final tax of 15% on their revenues from Finland and were only entitled to make certain limited deductions. Resident artists and sportsmen, however, were taxed at progressive rates and could deduct the actual expenses linked to their income (see also [EU Tax News 2009 – nr. 002](#) for more detail).

As a result of the Reasoned Opinion, Finland amended the legislation in order to bring it into line with EU Law. Currently, non-resident artists and sportsmen residing in the EEA are still subject to a 15% withholding tax on their revenues from Finland. However, upon request they are now entitled to deduct direct costs linked to their income. The costs are taken into consideration by decreasing the withholding tax percentage on the tax-at-source card or by a withholding tax reclaim procedure. The amended legislation entered into force on 1 January 2010.

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## **Germany – Supreme Fiscal Court extends its earlier ruling on punitive lump-sum taxation of investors in so-called 'black investment funds' to third-country funds**

On 25 August 2009, the Supreme Fiscal Court (BFH) ruled that domestic shareholders in foreign non-registered investment funds from third countries may not be subjected to punitive lump-sum taxation. It thus extended its earlier ruling from 2008 where it found a punitive tax on shareholders in so-called black investment funds resident in the EU/EEA to be in breach of the freedom of capital movement to black investment funds from third countries / non EU-Member States (see also [EU Tax News 2009 – nr. 002](#)).

Qualification as a black investment fund under the former Foreign Investment Act (abolished as of 1 January 2004), i.e. funds which altogether decline to comply with the detailed notification and publication requirements for investment funds, 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.

As this provision had come into effect before 31 December 1993, the court particularly tested, and denied, the applicability of the standstill clause in Art. 57 EC. First, it stated that fund shareholdings do not qualify as direct investments in the sense of Art. 57 Sec. 1 EC as such shareholdings would not convey actual power to participate in or to control the fund management. Second, the court dismissed that the tax provision in question can be

understood as a regulation on the provision of financial services in the sense of Art. 57 Sec.1 EC. The court interpreted Art. 57 Sec. 1 EC to only cover such national provisions which aim at financial institutions and regulate the way in which financial services are provided by them. However, tax provisions such as the punitive tax provision which levy tax on the individual investor can according to the court not fall within the scope of Art. 57 Sec. 1 EC.

The present case concerned investment holdings by two German individuals in Chinese and South Korean investment funds during the years 1990 to 1998 which were qualified as black investment funds. As in its earlier case, the court found the freedom of capital movement also to be restricted in a third country scenario as an investment in a domestic fund would not be subject to a punitive lump-sum tax. Though the court conceded that in the case of third countries the requirements for justifying a breach are principally lower, in particular as regards effective tax supervision and the determination of the correct tax base, it however found the provision not to be proportionate. Again, the court regarded the absence of the possibility to demonstrate actual profits by the investor as well as the resulting excessive tax equally as disproportionate in a third country case.

The court refrained from a referral to the ECJ based on the C.I.L.F.I.T.-decision (C-283/81) as it regarded the EU law situation to be unambiguous.

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#### **Germany – Lower Finance Court decision on final French PE losses**

On 18 November 2009, the Lower Finance Court of Hamburg decided on a cross-border loss case (Ref.-No. 6 K 147/08).

The plaintiff, a German resident GmbH, conducted business via two permanent establishments (PEs) situated in France. In the years 1998 until 2001, these PEs generated losses which were tax exempt according to the double tax treaty, and both PEs were closed in 2001. Following the decision in the *Lidl Belgium* case (C-414/06), the plaintiff applied for an in-phase deduction of these losses from the tax base for the purpose of both corporate income tax as well as trade tax for the years 2000 and 2001.

In the court's view, the plaintiff has proved successfully that these PE losses were final, as they actually could not have been used either by carrying back or forward. Moreover, considering that the PEs were closed down, the court acknowledged the impossibility to transfer these losses (and the PE) to a different entity and therefore concluded that these losses were final ones within the meaning of the *Lidl Belgium* decision. The court accepted an in-phase deduction as the most appropriate way of considering foreign losses and interpreted the proof of finality by the taxpayer as a fact with retroactive effect which leads in general to a reopening of already statute barred tax assessments. However, the court only consented to a deduction of final foreign PE losses from the corporate income tax base, but not from the trade tax base. As trade tax would only be levied on business conducted in Germany, the denial of a loss deduction of foreign located business would comply with the European principle of coherence.

The plaintiff as well as the tax authority appealed against this decision on a point of law. The case is now pending with the Federal Finance Court.

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### **Germany – Ministerial decree on the *Deutsche Shell* case**

On 23 November 2009, the Ministry of Finance published a decree concerning the application of the ECJ judgment in the *Deutsche Shell* case ([C-293/06](#)).

According to this decree, the currency loss of a foreign permanent establishment (PE) has to be taken into account with the German head office no earlier than in the year of the PE's liquidation. In this respect, the decree refers explicitly to para. 44 of the judgment in the *Deutsche Shell* case.

However, this decree could be doubted since neither para. 44 nor any other paragraph of the ECJ judgment does state anything on the timing. With respect to currency losses by a disposal of participations, the decree contains no comment.

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### **Germany – Pending Federal Finance Court decision on recapture of PE losses**

On 5 February 2009, the Finance Court of Cologne decided on a cross-border loss case which has recently been published and is now pending with the BFH.

A German corporation was a partner in a Luxemburg resident partnership which generated losses in 1989 of about 21 m. Euro. In 1999, the partnership generated profits of 0.5 m Euro. According to former German tax law (Sec. 2 para. 3 ITA), losses of a foreign permanent establishment (PE), although tax exempt under the respective double tax treaty, could be deducted from the tax base of the German partner/head office under the condition of a subsequent recapture when future profits occur. Although Sec. 2 para. 3 ITA was abolished from 1999 onwards, within a transitional period of 10 years formerly deducted losses are to be recaptured. For the case at hand the German tax law was conducted by deducting the whole losses in 1989 and recapturing 0.5 m Euro subsequently in 1999. The claimant appealed against the tax assessment of 1999 as to be in breach of the freedom of establishment, arguing that the loss of 1989 could actually not be used in Luxemburg anymore due to the timing restriction of a loss carry forward of only five years (here: until 1995) and that the recapture should therefore be waived.

This case has some similarities with the *Krankenheim* case ([C-157/07](#)) in which Germany recaptured formerly deducted Austrian PE losses, although these losses could not have been used in Austria. The ECJ had decided that the German recapture was not in breach of EC law, as it forms part of the principle of symmetry and therefore fulfils the requirements of the principle of coherence. Furthermore, the ECJ held that the restriction is attributed to Austria and not to Germany.

We would like to point out that neither the *Krankenheim* case nor the actual pending case deal with the consideration of final losses but only with a subsequent partly recapture. The losses remaining after the recapture (losses in total) do still reduce the tax base in Germany. The oral hearing at the BFH was scheduled to be held on 3 February 2010.

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### **Hungary – Main tax legislative amendments from 1 January 2010**

The Hungarian Parliament passed amendments to the tax regulation as of 1 January 2010. The corporate income tax (CIT) rate is increased by 3% to 19% and the 4% special profit tax payable by companies is abolished. No withholding tax on interest, royalty and service fees paid to foreign entity if there is a double tax treaty in place. Otherwise, a withholding tax of 30% may apply.

In the case of foreign residents, income from the alienation of shares in a real estate owning company or income from the withdrawal of registered capital through capital reduction in a real estate owning company may be subject to Hungarian CIT as the definition of real estate owning company is introduced. A domestic or a foreign company qualifies as a real estate owning company if at least 75% of its assets or of the total assets of the company and its related parties is domestic real estate and if it has a foreign shareholder that is not resident in a country that has a double tax treaty in place with Hungary, if the foreign shareholder is resident of a country that has a double tax treaty in place with Hungary that allows a foreign exchange gain to be taxed in Hungary.

The definition of controlled foreign company (CFC) was changed significantly. If the company is owned by a resident individual or the majority of its income derives from Hungarian sources and in both cases the effective tax rate is lower than 12.66%, the company falls under the Hungarian CFC rules. The CFC rules are not applicable if the foreign company has its seat or residence in the EU or in the OECD, or in a state with which Hungary entered into a double tax treaty provided the company has real economic presence in these countries. Furthermore, a foreign company does not fall under the definition of CFC if a person registered at a recognized stock exchange at least for 5 years on the first day of the tax year or its related party has at least 25% participation in the foreign company during the entire tax year.

Interest received from abroad may be partially exempted from the CIT base under a new unilateral relief. The exempted interest income is 75% of interest income received less the direct and indirect cost related to the interest and modified with the associated tax base decreasing and increasing items.

Concerning the transfer pricing regulations, the definition of related party was changed. A foreign PE of an Hungarian company and an Hungarian head office also qualify as related parties and are subject to Transfer Pricing regulations, which have to be applied to in-kind contributions made at the time of establishment.

In the case of legislative changes or changes in the facts confirmation on the application of an existing ruling can be requested, provided that this change does not have a significant effect on the ruling; the fee for this is 50% of the fee due for the original binding ruling. A ruling can be requested for ongoing transactions as well if certain conditions are met.

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### **Italy – Repeal of the new tax regime on proceeds paid out by EU/EEA non-UCITS funds**

Section 14 of the Law Decree nr. 135 of 2009, adopted by the Italian parliament on 25 September 2009 in order to introduce a new tax regime for the proceeds paid out to Italian tax resident individuals by certain EU/EEA non-UCITS funds, has not been converted into Law.

As a consequence, the previous regime has to be applied and the effects already produced by the new rules have to be removed.

Therefore, proceeds distributed by foreign EU/EEA non-UCITS funds to Italian tax resident individuals still have to be included in their whole taxable income and taxed at a tax-rate ranging from 23% to 43%, whilst the proceeds distributed by Italian non-UCITS funds are still subject to a 12.5% substitute tax at the date of payment.

For more information, [please refer to the EUDTG Newsletter 2009 - nr. 006](#).

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### **Netherlands – Dutch State Secretary for Finance opts for limitation of interest deduction for takeover companies and exclusion of PE losses**

On 5 December 2009, the Dutch State Secretary for Finance sent a letter to the House of Representatives explaining the state of affairs with regard to the allocation of the corporate tax burden and the issue of interest taxation. As you might know, the State Secretary published a Consultation Document CIT 2010 on 15 June 2009. Various reactions to the document have been submitted by the business community and other parties. As a response to that, the Ministry of Finance has decided to include the relaxations of the participation exemption regime in advance in a bill that was published in September 2009 on *Prinsjesdag* (Dutch budget day) as part of the 2010 tax package. This bill ("Other tax measures 2010") has already been accepted by the House of Representatives and the Senate and will become effective on 1 January 2010. With regard to the tax treatment of interest, the State Secretary needed more time.

#### ***Takeover companies***

In his letter, the State Secretary accepted only one of the measures that were announced in the Consultation document. In the legislative proposal, he will include a regulation providing for

a limitation of the deductibility of interest for takeover companies in case of a highly leveraged takeover of a Dutch target, if the target forms part of a fiscal unity with a Dutch takeover company after the acquisition. The interest will only be tax deductible if the buying company has enough taxable profits on its own. The State Secretary did indicate in the letter that real financial structures will be respected.

### ***Foreign PEs***

Another measure that the State Secretary is considering to propose, which was not included in the Consultation document, will exclude the losses of foreign permanent establishments from the Dutch tax base. The measure would lead to a more equal treatment of permanent establishments and participations on this matter. The subject-to-tax requirement for the avoidance of double taxation with regard to foreign permanent establishments would then be cancelled. Losses upon liquidation of permanent establishments will continue to be deductible.

### ***Compulsory group interest box***

The announced compulsory group interest box, in which interest received from group companies would be taxed at an effective rate of 5% and group interest expenses would be deductible at an effective tax rate of 5%, will only be introduced if the interests of foreign investors can be sufficiently met. For the time being, the State Secretary does not see how he can realise this. Perhaps a fundamental reform of the corporate income tax, being contemplated by a recently installed Study Committee of the Tax System, can remove the currently acknowledged objections against the group interest box. This implies that the State Secretary *will not* include the group interest box in a legislative proposal at this moment.

### ***Interest for participations and earnings stripping***

In his letter of 5 December, the State Secretary indicates that developments in ECJ case law have led to a reconsideration of the measures that were proposed in the Consultation document. As a result of this reconsideration, the State Secretary *will neither* propose a limitation of interest deduction for participations, *nor* the alternative of a general earnings stripping measure. The limitation of interest deduction for participations would have meant that the deduction of interest on third-party debt for participations would be limited, to the extent that the amount of cash invested by a Dutch parent company in its subsidiary companies (participations) exceeds its own average equity. In this respect, it would be irrelevant whether there is a direct relationship between the debt of the parent company and the amounts invested in the subsidiary companies. The earnings stripping measure would have held that the deduction of interest would be limited to a fixed percentage (30%) of the earnings before interest, taxes, depreciation and amortisation (EBITDA). The amount of interest expenses that would be disallowed in one year could have been carried forward to a future year in which the interest expense incurred is less than 30% of EBITDA.

In the press release published with the letter of the State Secretary, it is indicated that the proposals will be further elaborated in a legislative proposal, which is expected to be submitted to the House of Representatives this spring.

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## **Portugal – Tax Regime for non-habitual residents**

A new regime with Personal Income Tax (PIT) concessions for non-habitual residents in Portugal has been published, aiming to attract high level professionals and Centers of Excellence of MNCs. The qualifying activities are established in a separate ruling being covered by this new regime namely, engineers, auditors, tax consultants, IT programmers and management consultants, among others.

With effect from 2009, an individual may benefit from this new regime for 10 consecutive (and renewable) years if the individual qualifies as a tax resident in Portugal and has not been taxed as a Portuguese tax resident in any of the 5 years preceding the year in which residence is established.

Portuguese source wages and self-employed income would be subject to taxation at a 20% tax rate, if derived from high added value activities with a scientific character, artistic or technical nature.

Non-Portuguese source employment income will be exempt from Personal Income Tax (PIT) if the source country taxes the relevant income under the terms of the Portuguese Double Tax Treaty (DTT) with such country, or the income is taxed in the other country, territory, or region (if Portugal has not signed a DTT) and the income is not considered to be obtained in Portugal.

Non-Portuguese source self employment, real estate, capital income and capital gains will also be PIT exempt, if the income may be taxed in the other country with which Portugal has a DTT, or the income may be taxed in the other (non blacklisted) jurisdiction following the OECD Model of Taxation and the observations and reservations made by Portugal.

Pensions obtained outside Portugal will be PIT exempt (provided the related contributions were not tax-deductible in Portugal), if the income is taxed in the other country under the terms of the DTT, or the income is not considered as obtained in Portugal for tax purposes.

The taxpayer may, however, choose to subject all his relevant worldwide income to PIT and claim a foreign tax credit.

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## **Switzerland – Swiss Government adopts and publishes dispatches on revised double tax conventions with Denmark, France, Mexico, the UK and the US**

On 27 November 2009, the Swiss Government adopted and published five dispatches on the revised Double Tax Conventions (DTC) with the United States, Denmark (including Faroe Islands), France, Mexico and the UK in an initial batch which will be transferred to the Parliament. These treaties include (amongst other amendments) a clause on the exchange of information according to article 26 of the OECD Model Convention. However, as a (provisional) consequence of the theft of HSBC client data by a former employee of HSBC and their subsequent delivery to the French authorities, the Swiss Government announced on 16 December 2009 a suspension of the ratification process of the DTC with France until further notice. The matter is now referred back to the political level. Other EU Member States with which Switzerland has concluded or is currently negotiating a DTC implementing the OECD standard of information exchange include: Austria, Finland, Luxembourg, The Netherlands and Poland. Negotiations are also under way both with Italy and Germany. However with regard to Italy the negotiations have proven to be difficult, especially in the light of the recent Italian tax amnesty which was also aimed at non-declared funds located in Switzerland.

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## **United Kingdom – Thin Cap GLO: UK High Court decision**

On 17 November 2009 the UK High Court decision in *Test Claimants in the Thin Cap Group Litigation v HMRC* (the “Thin Cap GLO”) was published. The case concerns the compatibility of the UK pre-2004 thin capitalisation rules with the EC Treaty (now the Treaty for the Functioning of the European Union (TFEU)) and had been referred back to the UK courts following a preliminary ruling by the ECJ in March 2007 (see: [EUDTG Newsletter 2007 - nr. 003](#))

In summary, the UK High Court held that the UK pre-2004 thin capitalisation rules are in breach of the freedom of establishment, and this breach cannot be justified since the thin capitalisation rules did not provide any exemption for genuine commercial transactions. Consequently the rules cannot apply in EU situations (i.e. where an EU parent company lent to its UK subsidiary, or a foreign (EU or third country) sister company lent to a UK company with a common EU parent company) where the transactions as a whole were commercially motivated. The UK tax authorities are expected to appeal against this decision.

Companies which have suffered additional tax or consequential loss as a result of the application of the UK pre-2004 thin capitalisation rules may, subject to normally a 6 year time limit, now be entitled to make claims for repayment of tax or damages, including repayment of additional corporation tax paid as a result of an interest disallowance under the thin cap rules, compensation for losses used by the borrowing company to offset additional corporation tax liabilities arising due to application of the thin cap rules and (via High Court claims) compound interest.

The judgment also raises the question of the compatibility of other areas of UK legislation with the TFEU, including the post-2004 thin cap and transfer pricing rules and the new debt cap regime. See also EUDTG [Newsalert 2009 – nr 028](#).

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### **United Kingdom – Vodafone 2 CFC case: Court of Appeal decision now final**

As previously reported, in May 2009 the UK Court of Appeal held that the UK CFC regime is capable of being interpreted in a way that is consistent with the EC Treaty (now the Treaty for the Functioning of the European Union (TFEU)) and cannot be disapplied in its entirety (see: [EUDTG Newsletter 2009 - nr. 004](#)). Vodafone 2 has now been refused leave to appeal to the UK Supreme Court and consequently the Court of Appeal decision is now final. However, even based on the Court of Appeal's decision, CFCs which are established in an EU or EEA member state and carry on genuine commercial activities there or elsewhere in the EU or EEA should still be able to rely on the TFEU freedom of establishment to avoid a CFC charge.

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## EU DEVELOPMENTS

### EU – European Tax Commissioner-designate wants CCCTB back

On 11 January 2010, the European Parliament started its official public hearings of the 26 European Commissioners-designate, which were presented by European Commission president-elect Barroso in the last week of November 2009. According to the EC Treaty (now: Treaty on the Functioning of the European Union – TFEU) Members of the European Parliament (MEPs) have the right to endorse or reject the whole College of Commissioners.

The proposed new EU Commissioner for taxation and customs union, audit and anti-fraud is Algirdas Semeta. He has twice been Lithuania's Minister of Finance, from 1997-1999 and from 2008-June 2009. He was heard by Members of the EU Parliament's Budgetary Control, Economic and Monetary Affairs and Internal Market Committees on 12 January 2010. Many of the MEPs were not at all impressed by Mr Semeta's performance and it initially remained unclear whether he could muster enough support.

Interestingly, replying to questions from MEPs Mr Semeta appeared to be a strong advocate of revamping the EC's CCCTB project and of tax harmonisation in general. He added that if need be the CCCTB should be implemented by means of the enhanced cooperation procedure, now Article 20 TFEU, which requires that at least a third of all EU Member States could agree to implement CCCTB in their territories. His support for the CCCTB is rather remarkable as Lithuania has opposed the introduction of CCCTB for the past 5 years; during which Mr Semeta served his second term as Lithuania's Minister of Finance.

On taxation, tax havens and banking secrecy Mr Semeta told MEPs that he wanted to remove "unsensible barriers and obstacles to free movement of goods and services", promote fair tax competition within the EU, avoid double taxation, and that he was in favour of a general simplification of the tax system and harmonisation of tax calculation rules in Europe. He was quoted as saying that in the field of taxation, there are still many loopholes and that it was his goal and that of the designated French Internal Market Commissioner Michel Barnier, "to close the loopholes" ..

On "tax havens", within or without the European Union, Mr Semeta said that when appointed, he would combat tax evasion and tax avoidance and engage in initiating agreements with countries such as Liechtenstein, Andorra and Switzerland to prevent tax revenue moving out of Europe. He declared that harmful tax practices, including shifting business profits, should be counteracted proactively.

On banking secrecy, Mr Semeta emphasised the importance of automatic exchange of certain banking information and said he would try to turn around the current opposition from Austria and Luxembourg on this point

The European Parliament plenary vote was set to take place on January 26 2010 but was delayed until 9 February due to the rejection of the initially proposed Bulgarian Commissioner-

designate. If endorsed by Parliament, the "Barroso II" Commission will start its 5-year mandate on 10 February 2010.

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### **Belgium – European Commission formally requests Belgium to amend legislation implementing the Parent-Subsidiary Directive**

On 20 November 2009, the European Commission sent a Reasoned Opinion (the second step of the EU's infringement procedure) to Belgium requesting it to amend its implementing legislation regarding the Parent-Subsidiary Directive (90/435/EEC). The Belgian rules introduce an additional condition to those specified in article 3 of the Directive.

Article 3 of the Parent-Subsidiary Directive stipulates the conditions for its application. The Directive must be applied when a company has a minimum holding of 10% in the capital of a company of another Member State, leaving no room for further conditions. The current Belgian legislation implementing the Directive stipulates that a shareholding must also be considered as a "fixed financial asset" for the Directive to apply. As a consequence, companies not fulfilling this requirement cannot benefit from the Parent-Subsidiary Directive. The Commission's case reference number is 2007/4333.

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### **Germany – European Commission formally requests Germany to amend its legislation on outbound dividends and interest payments to foreign pension institutions**

On 29 October 2009, further to its formal notice as of 31 January 2008 (first step of the infringement procedure of Art. 226 of the EC Treaty, see EUDTG Newsalert [NA 2008-006](#)), the European Commission sent a Reasoned Opinion to Germany asking it to amend its legislation (second step of the infringement procedure).

The decision regards Germany's rules on the taxation of "Pensionskassen" and "Pensionsfonds" and their corresponding institutions established in the EU and the EEA.

As to "Pensionskassen", dividends paid by German companies to German "Pensionskassen" are either subject to a reduced withholding tax rate, or the "Pensionskasse" can benefit from a partial refund of the withholding taxes. However, similar institutions established elsewhere in the EU and the European Economic Area cannot benefit from this reduced rate or partial refund and are subject to a final withholding tax of 26,375 %.

Dividends received by German "Pensionsfonds" are taken into account in the annual tax assessment procedure and are taxed on a net basis after deducting premium reserves at the general corporate tax rate of 15,825 %. However, dividends paid from a German company to

similar foreign institutions are subject to a final withholding tax of 26,375 % on the gross dividend, without the possibility of deducting any costs.

The same rules apply to interest payments paid to "Pensionskassen" and "Pensionsfonds". The Commission holds that under the current regime pension funds might be dissuaded from investing in companies in Germany and companies established in Germany might have difficulty attracting capital from foreign pension funds. The higher taxation of foreign pension funds may thus result in a restriction of the free movement of capital, as protected by Article 56 EC and Article 40 EEA.

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### **Lithuania – European Commission sends a second Reasoned Opinion to Lithuania concerning its discriminatory taxation of outbound interest and royalties**

On 20 November 2009, the European Commission announced to have sent an additional Reasoned Opinion (the second step of the EU's infringement procedure) to Lithuania about its rules under which interest paid to foreign variable capital investment companies and closed-end investment companies (including investment funds and pension funds) is taxed more heavily than interest paid to comparable domestic recipients. This additional Reasoned Opinion also addresses the taxation of royalty payments to non-resident companies.

In the case of interest and royalty payments, where resident companies can deduct expenses related to such income from their taxable income while non-resident companies are denied such deduction, this may also result in a restriction of the freedom to provide services. The Commission said that it is not aware of any justification for such restrictions. The Commission's case reference number is 2006/4095.

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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/eudirecttax](http://www.pwc.com/eudirecttax).

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