

# TAXeNEWS Europe



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## ECJ CASES

### **Belgium – ECJ judgment on Belgian provision on abnormal and gratuitous benefits: Société de Gestion Industrielle case ([C-311/08](#))**

On 21 January 2010, the ECJ ruled in the *Société de Gestion Industrielle* (SGI) case that the Belgian application of the “at arm’s length” principle according to which cross-border situations are taxed differently compared to national situations, does not infringe the freedom of establishment under Article 49 of the Treaty on the Functioning of the European Union - TFEU (former Article 43 EC Treaty).

A Belgian company generally grants or receives a so-called abnormal or gratuitous benefit when a transaction does not take place at market conditions (at arm’s length). In the present case, the Belgian tax authorities considered that the Belgian company SGI had granted some benefits to a foreign subsidiary (interest-free loan) and to one of its shareholders (excess director’s remuneration), and added back these benefits to the taxable basis of SGI based on Article 26 BITC.

According to the ECJ, the freedom of establishment does not preclude a provision such as Article 26 BITC according to which benefits granted by a Belgian resident company to a non-resident related company should always be added back to the taxable basis of the Belgian company, whereas benefits granted to a Belgian related company would usually not be added back to the taxable basis of the Belgian grantor as the benefits are already included in the taxable basis of the Belgian beneficiary.

Theoretically, taking into account the purpose of the legislation concerned, the ECJ considered that Article 26 BITC can affect the exercise of both the freedom of establishment and the free movement of capital. Given the benefits were actually granted to companies with which SGI had a relationship of interdependence characterised by ‘definite influence’ within the meaning of the *Baars* case-law ([C-251/98](#)), the ECJ considers that *only* the freedom of establishment is applicable to the present case.

The ECJ considered that Article 26 BITC constitutes a restriction on the freedom of establishment as the difference in treatment between national and cross-border situations could deter from acquiring, creating or maintaining (a substantial holding in) subsidiaries in other Member States. However, it ruled that this restriction is justified by the need to ensure a balanced allocation of the power to tax between Member States, the fear of tax avoidance and the need to combat abusive practices, taken together.

Importantly, the ECJ considered that Article 26 BITC does not go beyond what is necessary to reach its goals (proportionality) provided that, when there is a suspicion that a transaction is not “at arm’s length”, the taxpayer is given the opportunity to provide evidence of any commercial justification for that transaction (right of reply) and provided that the adjustment is confined to the amount which exceeds the “at arm’s length” price. See also [EU Tax News Issue 2009 – nr 006](#) for AG Kokott’s Opinion.

-- Olivier Hermand, Patrice Delacroix and Mathieu Protin, Belgium; [olivier.hermand@pwc.be](mailto:olivier.hermand@pwc.be)

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

On 25 February 2010, the ECJ ruled in the case of *X Holding BV* that the Dutch fiscal unity regime is not in breach of the freedom of establishment under EU Law insofar as it disallows a cross-border fiscal unity.

Under the Dutch regime, fiscal consolidation is permitted between a Dutch parent company and its Dutch subsidiary, but not between a Dutch parent company and a subsidiary in a different EU Member State. The formation of a Dutch fiscal unity can have a number of advantages from the perspective of the taxpayer. These include the possibility to consolidate losses between group companies, and the option of tax neutral restructuring. The ECJ recognised this difference in treatment as constituting a *prima facie* restriction of EU Law, as it gives rise to a disadvantageous treatment in the cross-border situation.

In its judgment, the ECJ took the view that the restriction caused by the impossibility of forming a cross-border fiscal unity can be justified from the perspective of maintaining the allocation of taxation rights between EU Member States. In particular, the ECJ held that the Dutch regime may pave the way for the arbitrary shifting of losses between EU Member States.

When considering whether the *prima facie* restriction caused by the Dutch fiscal unity regime can be justified, the ECJ only made specific reference to some of the issues connected to the cross-border use of losses between consolidated group companies.

None of the other advantages of the fiscal unity (e.g. the transfer of assets between group companies without immediately triggering a taxable capital gain) were effectively dealt with by the ECJ, although AG Kokott had signalled in her Opinion of 19 November 2009 (See [EU Tax News Issue 2010 – nr 001](#)) that the denial of benefits other than the use of losses may, by itself, already constitute a restriction of EU Law. .

Furthermore, it is noteworthy that the ECJ pays no attention to the treatment of final losses in the sense of its 2005 *Marks & Spencer* judgment ([C-446/03](#)). In that case, it held that the restriction of the use of losses in a cross-border situation would constitute a disproportionate measure where no other possibility of utilising these losses would be available. It is not yet clear how the X-Holding judgment relates to the earlier position taken in *Marks & Spencer*.

Both the issue of 'exit taxation' and the issue of relief for 'final losses' seem to have remained open. The same applies to other rules which are impacted by the fiscal unity regime. The Dutch Supreme Court will have to deal with those issues when the case is referred back to it. See also: EUDTG [Newsalert 2010 – nr 002](#).

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## **Portugal – Update on ECJ referral on Portuguese taxation of dividends paid to foreign pension funds ([C-493/09](#))**

As a result of the discriminatory treatment of foreign pension funds under the Portuguese Tax Law, the European Commission decided to refer Portugal to the ECJ on 27 November 2008. The formal EC application was sent to the ECJ on 1 December 2009.

See [EU Tax News Issue 2009 – nr. 001](#) for detailed information.

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## **Spain – ECJ judgment on action for damages against the State**

On 26 January 2010, the ECJ concluded in case [C-118/08](#) that EU Law precludes a national rule such as the Spanish rule which allows actions for damages against the State alleging breach of its law established by a judgment of the ECJ only if all domestic remedies for challenging the validity of the relevant law provision have been exhausted by the applicant, when such a rule does not apply to actions for damages against the State alleging breach of the Constitution by national legislation established by the competent national court. Therefore, a taxpayer may use the procedural rules for unconstitutional legislation when they bring an action for damages against the State based on legislation violating EU Law.

The Transportes Urbanos y Servicios Generales case concerned a Spanish VAT legislative provision. However, the case has consequences for EU Law violations in Spanish legislative tax provisions of any kind, amongst others:

- capital duty paid when incorporating a branch or a PE in Spain by entities located in other EU Member States.
- income tax paid by individuals resident in EU Member States other than Spain in relation to capital gains subject to a 35% tax rate instead of 15% or 18% (Case [C-153/08](#))
- dividend tax withheld on dividends paid to non-resident EU companies, which hold a participation in a Spanish company of more than 5% but less than the threshold established in Directive 90/435 (Case [C-487/08](#)).
- tax paid at source on dividends or interest paid to pension funds in other EU Member States.

The ECJ judgment effectively means that taxpayers, both residents and non-residents, may successfully claim a refund for taxes which have been paid in violation of EU Law within the time frame and limitations set by domestic law which governs the Administration's liability. It is important to note that unlawfully paid taxes which are tax barred, may be claimed under the domestic tax norms following the procedure established in the provisions of Spanish Administrative Law.

We recommend taxpayers to bring actions for damages against the State alleging breach of its law established by a judgment of the ECJ within one year as from the date of the relevant ECJ judgment.

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## NATIONAL DEVELOPMENTS

### **Austria – Carry forward of foreign withholding tax after the ECJ’s Damseaux decision and the pending Österreichische Salinen AG case**

In September 2009, the Austrian Ministry of Finance issued the opinion to grant – upon application and on a discretionary basis – a carry forward of foreign withholding tax (on foreign source income) if Austrian taxpayers were not able to credit the foreign withholding tax against their Austrian tax liability in the same period the withholding tax arises, since no tax or insufficient tax in Austria was accrued. Thus, the taxpayer was able to carry forward the foreign withholding tax to future periods and could therefore credit the foreign withholding tax in profitable periods where Austrian tax falls due. The reason for this approach was to prevent Austrian taxpayers from inter-temporal double taxation and therefore to be in line with EC (now: EU) Law.

The ECJ’s *Damseaux* decision ([C-128/08](#)) triggered a change in the Austrian Ministry of Finance’s opinion with regards to the possibility to carry forward foreign withholding tax. Due to the fact that the ECJ – as already done in *Kerckhaert-Morres* ([C-513/04](#)) – decided that non-discriminatory double taxation within the EU is in line with EU Law the Austrian Ministry of Finance came to the opinion that lacking the possibility to carry forward foreign withholding tax, as defined under Austrian tax law, does not violate EU Law. Therefore, the Ministry of Finance, in February 2010, issued the opinion that applications regarding the carry forward of foreign withholding tax to future periods will not be approved any more.

However, in the course of the pending case ([C-437/08](#)) *Österreichische Salinen AG* (see [EU Tax News Issue 2010 – nr.001](#)), the Austrian Fiscal Court of Appeal referred the question to the ECJ, whether an obligation to allow Austrian taxpayers in loss positions to carry forward foreign withholding and/or respectively foreign corporate income tax can be derived from EU Law. Therefore, the ECJ’s decision in *Österreichische Salinen AG* will finally show whether the new approach applied by the Austrian authorities regarding the possible carry forward of foreign withholding tax is in line with EU Law or not.

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### **Belgium – New rules for payments made to tax havens**

As from 1 January 2010, companies subject to Belgian corporate income tax or Belgian non-resident corporate income tax who make direct or indirect payments to recipients established in so-called tax havens are obliged to declare these payments if they exceed EUR 100,000 during the tax year. A special form has to be enclosed to the (non-resident) corporate tax return.

A tax haven is defined as: (i) a jurisdiction regarded by the OECD as not being cooperative concerning transparency and international exchange of information, or (ii) a jurisdiction where the nominal corporate tax rate is less than 10%. A Belgian Royal Decree contains the list of

countries where the nominal corporate tax rate is lower than 10% is to be published (section 134, Program Act).

In the event of non-reporting, the payments will be disallowed for corporate income tax purposes. Where the payments have been duly reported in time, their tax deductibility will be subject to the ability of the taxpayer to prove that (i) said payments were made as part of genuine, proper transactions and (ii) they were not made to an entity under an artificial construction (section 128, Program Act).

Given the fact that the freedom of establishment protected by the Treaty on the Functioning of the European Union - TFEU (former EC Treaty) is also applicable in relation to Third Countries, the question arises whether the above reporting obligation could be considered as incompatible with the EU's freedom of establishment, knowing however that the taxpayer has the ability to prove the genuine non-artificial nature of the transaction as mentioned above.

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### **Belgium – Royal Decree on the renunciation of the collection of withholding tax on investment income in response to European Commission action**

On 22 February 2010, a Royal Decree entered into force amending certain specific provisions of the Belgian tax legislation providing for a higher taxation of investment income for non-Belgian entities following two formal requests of the European Commission in this respect.

Article 105 of the Royal Decree implementing the Belgium Income Tax Code (hereafter RD/BITC), within the framework of the (partial) renunciation of Belgian withholding tax, defined that one of the cumulative conditions in order for an entity to be considered as a “financial or comparable institution”, was that its shares (i) should be traded on a regulated market or (ii) should, with a minimum of 50 percent, be directly or indirectly held by a company subject to corporate income tax or a similar foreign tax, which does thus not benefit from a tax regime which can be considered as substantially falling outside the standard corporate income tax regime or as substantially more favourable than the Belgian corporate income tax.

In order to align this provision with other provisions of the BITC and also following a formal request of the European Commission in this respect on 28 January 2010 (see [below](#)), the Royal Decree of 22 February 2010 provides that the above condition should be completed with the assumption that the general tax regime applicable to companies in the EEA is considered not to be substantially more favourable than in Belgium.

Article 106, §3 of the RD/BITC provided for a specific withholding tax exemption on dividend income distributed to Belgian contractual funds (FCP) provided the FCP meets certain conditions and provided the FCP is recognised by the Minister of Finance, whereas the same income in the hands of similar foreign investment funds was taxed at a rate of 25% or 15%. In addition, these FCPs could also benefit from a withholding tax exemption on income deriving from money deposits, whereas such income was taxable at a rate of 15% in the hands of similar foreign investment funds. Following a formal request of the European Commission to

end this discriminatory treatment as announced on 28 January 2010 (see [below](#))), Belgium withdrew both withholding tax exemptions in the meantime (NB: the Belgian Minister of Finance has never recognised these Belgian FCPs, which may explain the relatively quick reaction by the Belgian Government).

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### **Germany – Federal Tax Court decision in last instance on the Columbus Container case**

The plaintiff, a Belgian limited partnership (Coordination Centre) with German resident partners, dealt with financing of subsidiaries and branches. Its profits and losses were assessed as foreign branch profits and assets of the German partners under German domestic law. According to the double tax treaty between Germany and Belgium, profits from and net assets of a Belgian partnership are exempt in Germany. However, the German International Transactions Tax Act (Sec. 20 par. 2 and 3) provides for a switch from the exemption to the credit method in respect of certain passive branch profits and assets. This provision was introduced to prevent circumvention of the CFC rules as laid down in Sec. 7 to 14 ITTA, which apply only to foreign subsidiaries. The application of Sec. 20 ITTA requires that the CFC rules would apply to the foreign branch in case it was a subsidiary.

On 6 December 2007, the ECJ decided that the German provision of Sec. 20 par. 2 and 3 ITTA is not in breach of the freedom of establishment and the free movement of capital. In its judgment, the ECJ had not considered the compliance of the underlying CFC rules themselves, but judged only on the switch-over rule. Afterwards, the referring Lower Finance Court decided in accordance with the ECJ and added that, even if the provisions of Sec. 7 to 14 ITTA did not comply with the freedom of establishment, this would not have any effect on the switch-over rule. See also [EU Tax News Issue 2008 – nr 001](#).

The Bundesfinanzhof (BFH - Federal Finance Court) has now disagreed with the Lower Finance Court and held in its judgment of 21 October 2009 that:

- The German CFC rules do not comply with EU Law, as they aim at avoiding tax abuse/circumvention without providing for a proof of the contrary.
- This incompatibility does not lead to a non-application of the provision but to a reading down with the effect that the taxpayer is given the possibility to prove that the arrangement is not wholly artificial.
- The effective (fictional) application of the CFC rules is a prerequisite of the switch-over rule and therefore even the switch-over rule requires the possibility to prove the contrary in order to be in line with EU Law. If the taxpayer can prove successfully that the arrangement is not wholly artificial, the switch-over rule is not applicable. In the BFH's view, the ECJ judgment in the *Columbus Container* case ([C-298/05](#)) would not oppose this finding, as the ECJ only judged on the mechanism of the switch-over itself without considering its prerequisites. The Coordination Centre at hand is considered not to be wholly artificial.

Although Germany introduced such a possibility of providing counter-evidence after the judgment in the *Cadbury Schweppes* case ([C-196/04](#)), such a proof is neither possible for the switch-over rule or situations underlying the free movement of capital. Therefore, the BFH considered in an obiter dictum the amendment to be only partly compliant with EU Law.

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### **Germany – Local Tax Court decision on in-phase utilisation of foreign losses**

On 8 September 2009, the Lower Finance Court of Düsseldorf decided on the timing to consider whether a final foreign PE loss arose at the level of the German head office (Ref.-No. 6 K 308/04 K).

In the case at hand the loss arose from depreciation expenses and could only be carried forward for a limited period of 5 years. The Court acknowledged the loss to be final in the meaning of the *Lidl Belgium* decision ([C-414/06](#)), as the loss - from a retrospective point of view - could not have been utilised during that 5-year period.

Regarding the timing to consider the loss at the level of the German head office, the Court disallowed an in-phase deduction at the beginning of the 5-year period, arguing that *at this point in time* it had not been foreseeable that the loss could not be offset against future earnings anymore. As the taxpayer had not been excluded from the possibility of utilising the loss carry forward before the end of the 5-year period, the head office could not deduct the loss before the end of this period.

In contradiction to this approach, the Lower Finance Court of Hamburg under comparable circumstances has accepted an in-phase deduction as the most appropriate way of considering foreign losses (see our [EU Tax News Issue 2010 - nr 001](#)).

The case is now pending with the Federal Finance Court (BFH, Ref.-No. I R 100/09).

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### **Germany – Lower Finance Court decision on the deductibility of final losses of a foreign subsidiary**

On 11 February 2010, the Lower Finance Court of Lower Saxony (6 K 406/08) decided that final losses of a foreign subsidiary could only be deductible from the tax base of the parent company under the condition that the parties concluded in advance a loss assumption agreement, lasting for at least 5 years. To our knowledge, the judgment will be appealed against on a point of law.

The plaintiff, a German resident holding company, established in 2002 two Italian resident subsidiaries which generated losses from the beginning. In the years 2002 until 2005, the parent company supported the subsidiaries by voluntarily granting benefits and giving out loans which were switched into equity afterwards. In 2006, it was decided to dissolve the subsidiaries. As write-downs on the shareholdings were not deductible for tax purposes, the

plaintiff applied for a deduction of the losses made by the subsidiaries in the respective years (2002-2005) referring to the *Marks & Spencer* case ([C-446/03](#)). Thus, the plaintiff applied, although not meeting the requirements, for treatment as a fiscal unity (Organschaft) by which profits and losses of the subsidiary are attributed to the parent company. However, according to sec. 14 of the German Corporate Income Tax Act (CITA) an Organschaft could only be set up with German resident subsidiaries (major shareholding) and requires the conclusion of a profit and loss pooling agreement in advance, lasting at least 5 years.

In the Court's view, the requirements of sec. 14 CITA and thus the per se exclusion of the Organschaft in cross-border cases were not in line with EU Law. Therefore, a treatment similar to the Organschaft should be possible for foreign resident subsidiaries as well at least when it comes to the consideration of the latter's final losses. As the conclusion of a profit and loss pooling agreement according to the German Stock Corporation Act is in fact not possible in most cross-border cases, this condition should be read down to its minimum requisite while considering what is feasible under company law. As the conclusion of a legally binding obligation to assume losses should be feasible under the various company laws of the EU, the Court stipulated this assumption to be the appropriate requirement. Further, the Court concluded that such a loss assumption agreement needs to be formally concluded in advance and for the duration of at least 5 years in order to set up an Organschaft cross-border. The fact that in the case at issue such a loss assumption has been conducted voluntarily without a binding obligation would, however, not fulfil this newly stipulated requirement. Therefore, the Court rejected the consideration of final losses.

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### **Germany – Pending case with the Federal Finance Court concerning the application of the free movement of capital for a qualifying Third Country participation**

In 2007, the plaintiff, a German resident individual, inherited a 100% shareholding of a company resident in Canada. According to the (former) German Inheritance Tax Act, the inheritance of a qualifying shareholding (>25%) of a German resident company was entitled to a special tax-free amount and the remaining value was assessed with only 65%. After the ECJ judgment in the *Jäger* case ([C-256/06](#)), concerning a similar evaluation of agricultural land, this tax relief has been extended to participations of EU/EEA resident companies, but is still denied to Third Country shareholdings. The tax relief for participations was introduced with effect of 1996. In view of the plaintiff, the denial is in breach of the free movement of capital.

The Lower Finance Court of Bremen (3 K 34/09) held in its decision of 28 October 2009 that this denial would be in line with EU Law as the restriction of the free movement of capital would only be the inevitable consequence of a restriction of the freedom of establishment which is not applicable to Third Countries. The Court refers to the judgment in the case *Lasertec* ([C-492/04](#)) in which the ECJ held a shareholding of 25% to be sufficient in order to have a definite influence on decisions and activities of the company. However, the Court acknowledged that if the free movement of capital were applicable, the denial would constitute a restriction which could not be justified. In the Court's view, Third Country shareholdings and German or EU/EEA shareholdings were in an objectively comparable situation which does not allow for a different

taxation. Furthermore, Art. 26 of the double tax treaty between Germany and Canada would provide for a sufficient exchange of information in order to check whether all requirements for the tax relief are fulfilled. The plaintiff appealed on a point of law; the case is now pending with the Federal Finance Court (BFH, II R 63/09).

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### **Germany – Case pending with the Federal Tax Court on "commercially maintained business establishment" in CFC legislation**

The case concerns the German CFC-legislation before the adjustments post *Cadbury Schweppes*. It is still of interest today, as it deals with the definition of a *commercially maintained business establishment*. Such establishment is required for insurance business to be considered active according to the CFC-legislation. If it can be affirmed, the income is not subject to the CFC rules.

A German insurer carried out business in Dublin through a wholly owned subsidiary, X Ltd. that fulfilled the requirements for the reduced corporation tax rate of 10% in respect of reinsurance contracts regarding risks outside Ireland. Together with two Irish resident sister companies (Y and Z Ltd.), X Ltd. founded a service company; XYZ Ltd. All three companies concluded service agreements with XYZ Ltd., according to which XYZ Ltd. was to carry out their management activities. Personnel were employed by XYZ Ltd., but had work agreements with X Ltd. and the two sister companies. The managing director of X Ltd. and its two sister companies was the managing director of XYZ Ltd. XYZ Ltd. had sufficiently equipped office facilities.

The Tax Court of Lower Saxony had to decide if the requirement of a *commercially maintained business establishment* was fulfilled. Such establishment is to be affirmed if the company has the necessary personnel and office equipment to carry out insurance business, if it keeps books, preserves records and draws up a balance sheet and inventory. The latter requirements were fulfilled. The question was if X Ltd. had sufficient personnel and office equipment. The tax authorities and parts of literature consider employment of own personnel necessary, whereas others consider management agreements with service companies sufficient.

The Court held - in the light of *Cadbury Schweppes* ([C-196/04](#)) and the jurisprudence of the Federal Tax Court - that the fact that X Ltd. neither had own employees nor an own office cannot in itself lead to the dismissal of a commercial business establishment. A company is not wholly artificial merely due to the insertion of a management company and its not having its own employees or office space. X Ltd. had a board of directors and was capable of decision making. Further, its operations were not carried out by a completely independent service provider or agent, but by the related XYZ Ltd. XYZ's Ltd. personnel were sufficient for the business of all three parent companies. In the Court's view, the overall picture is decisive when determining if X Ltd. (under attribution of XYZ's Ltd. activities) maintained a commercial business establishment. In this case, EU Law must be considered. X Ltd. can rely on the freedom of establishment, as this freedom does not require that the company operates *in the market* of the establishment country. Rather, it is sufficient that X Ltd. *in Ireland* carries out the

activity of insuring risks *outside Ireland*. It was shown that X Ltd. maintained a reinsurance business, which needed sufficient capital endowment but only a few employees with the right expertise. The Court held that X Ltd., with the existing personnel and in particular the managing director, maintained a commercial business establishment. The size of the capital endowment did not point to a wholly artificial construction.

The case is pending with the Federal Tax Court. The new CFC-rules provide for an escape within the EU/EEA if there is a *genuine economic activity*. The legislative material to the escape clause states that having one's own personnel is necessary to fulfil this requirement and that outsourcing is not sufficient. Should the Federal Tax Court rule that outsourcing is not harmful for the "*commercially maintained business establishment*" criterion, it seems questionable if something different can apply in respect of a *genuine economic activity*.

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## **Ireland – Finance Bill 2010**

Ireland's Finance Bill 2010 was published on 4 February 2010. Some of the elements of the Bill which may be of interest are highlighted below.

### *Carbon tax*

From an EU perspective, one of the most notable provisions relates to carbon tax. When the Budget was released in December 2009, the Minister for Finance asserted that participants in the EU Emissions Trading Scheme (ETS) would be entitled to a full exemption from carbon tax. However, the June 2009 European Commission Decision against Denmark, which was published in late December 2009, makes it clear that a full exemption would breach State Aid rules. All companies operating in the EU must pay at least the minimum rate of energy tax in accordance with the EU Energy Tax Directive (2003/96/EC). As a result of the EC Decision, ETS participants cannot be exempted from the carbon tax regime but, instead, they will be eligible for a reduced rate of carbon tax. Therefore, only partial relief will apply for ETS participants in relation to fuels specifically mentioned in the Directive i.e. coal and gas.

### *Taxation of dividends*

Ireland has also made certain amendments to its rules on the taxation of dividends to enhance the regime, which was introduced two years ago. Prior to Finance Act 2008, all dividends received from non-Irish tax resident subsidiaries were taxable at 25% while dividends received from domestic subsidiaries were exempt from Irish tax. Following the 2007 ECJ preliminary ruling in the *FII GLO* case ([C-446/04](#)), the legislation was amended to provide that dividends paid out of the trading profits of subsidiaries resident in the EU or in a country with which Ireland has a double tax agreement would be taxable at 12.5% (the rate applicable to trading profits of Irish companies). Finance Bill 2010 proposes to extend this lower tax rate to dividends paid out of trading profits of companies resident in non-treaty countries where the company is a 75% direct or indirect subsidiary of a company, the shares of which are traded on a recognised stock exchange in the EU or in a country with which Ireland has a double tax treaty.

However, if the UK High Court has interpreted the ECJ judgement in the FII GLO correctly, the Irish regime may still be out of line with EU Law as, unlike Irish resident companies with Irish resident subsidiaries, Irish resident companies with EU resident subsidiaries cannot benefit where the subsidiary is subject to an effective tax rate of less than 12.5%. Thus, we await, with interest, the outcome of the FII GLO, which has recently been referred back to the ECJ by the UK Court of Appeal for clarification. The question is whether the ECJ was referring to nominal or effective rates of tax when it held that both domestic and EU dividends should be subject to the same rate of tax. (See also item below on the [FII GLO – UK Court of Appeal decision](#))

#### *Transfer pricing*

Finance Bill 2010 also includes draft transfer pricing legislation, which endorses the OECD Transfer Pricing Guidelines and the arm's length principle and brings the Irish tax regime into line with international norms in this area. The new regime includes many features expected of a jurisdiction introducing transfer pricing rules for the first time, but two aspects of the draft legislation are expected to grab the attention of multinationals in Ireland:

- The new regime is confined to related party dealings that are taxable at Ireland's corporate tax rate of 12.5% (i.e. trading transactions); and
- A so-called "grandfather" clause is included whereby arrangements entered into between related parties prior to 1 July 2010 are excluded from the new regime. The grandfather clause creates a short lived opportunity for multinationals in Ireland to consider whether their arrangements fall outside the scope of the new transfer pricing rules.

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#### **Norway – PwC successfully assists a Luxembourg SICAV in Norway in getting a refund of withholding tax levied in breach of the EEA Agreement after the ECJ's Aberdeen judgment**

PwC Finland has assisted Aberdeen in the ground-breaking Aberdeen case (see also [EU Tax News Issue 2009 – nr 004](#)) where the ECJ concluded that Luxembourg SICAVs are covered by EU Law. PwC has also successfully argued that UK OIECs are covered by the Norwegian tax exemption method ("TEM") and thus entitled to a refund of withholding tax previously imposed in violation of the EEA Agreement. In September 2009, the Norwegian Ministry of Finance stated that their previous policy has been reversed and that Norway will comply with the decision in the *Aberdeen* case (Case [C-303/07](#)). Yet, the Norwegian tax authorities until now have been hesitant to conclude in specific cases, and are in the process of considering what procedural and documentation requirements they will impose.

On 25 January 2010, a settlement was reached with the Norwegian tax authorities on refunds for SICAVs. The case at hand concerned a Luxembourg SICAV which was an umbrella fund. In the period from 2002 to 2005, Norwegian companies had withheld over NOK 100 m in withholding taxes on dividend distributions to the Luxembourg fund. PwC Norway, assisted by PwC UK, filed a refund application in December 2005 based on EEA law arguments. COFTA denied the refund request in a decision in 2006, which was appealed at the tax appeal board at

COFTA. The appeal board upheld the decision in 2008. A summons was submitted in July 2009 which resulted in the settlement.

This case shows the importance of safeguarding potential refund claims by submitting applications and appealing against incorrect decisions by the tax office. The settlement should have a positive impact on pending and new refund cases at COFTA, and increase the chances of getting refunded for corporate based investment funds such as Luxembourg and French SICAVs, PLC based Irish investment funds and other corporate based investors.

We understand that similar cases have been put on hold pending the outcome of this case. It is expected that COFTA will start reconsidering these refund applications. The cases will be considered in the same order as they were submitted. The large number of cases to be reviewed is likely to give a time lag before corporate based investment funds receive the cash refund. We also expect that the documentation requirements for getting a refund will be largely the same as required by the tax authorities in relation to this case. The following documentation should be submitted along with a refund application:

- Dividend vouchers in original
- Tax certificate in original covering all relevant years (may be neutral without any reference to a tax treaty ie only domestic law)
- Excel spreadsheet with an overview of the information in the dividend vouchers
- Prospectus or similar document

*Norwegian appellate court decision regarding statutes of limitation in pilot cases*

Claims filed more than 3 years after the relevant income year could be disallowed, as illustrated by a recent appellate court decision won by the Norwegian State based on statutes of limitation arguments. The general statutes of limitation apply, so claims not submitted within a three year deadline expire. Also, the court agreed that no compensation claim can be made even though the Norwegian tax law was in violation of EEA freedoms. We expect this ruling to be appealed with the Supreme Court and an ensuing decision during 2010.

See also EUDTG [Newsalert 2010 – nr 001](#).

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**Poland – Polish tax authorities order the refund of unduly withheld dividend withholding tax levied on a Dutch pension fund**

On 25 February 2010 the Head of the Tax Office in Warsaw issued three decisions concerning a pension fund registered in the Netherlands (Dutch Pension Fund) confirming that Art. 6 sec. 1 point 11 of the Polish corporate income tax (CIT) law, which exempts from taxation only Polish pension funds, is in breach of the free movement of capital under Article 63 Treaty on the Functioning of the European Union – TFEU (former Article 56 EC Treaty), and that consequently the withholding tax unduly withheld on dividends paid to the Dutch Pension Fund by Polish companies should be refunded.

According to our best knowledge, these are the first decisions confirming the discriminatory nature of the Polish CIT law's provisions issued at the level of the Polish tax authorities. So far, in similar cases, the Polish tax authorities have been issuing negative decisions and taxpayers had to appeal to Polish courts. This may be the beginning of a new trend in this respect allowing for a cost efficient refund of too much levied withholding tax in the future.

In 2007 the Dutch Pension Fund received dividends from Polish companies on which 15% WHT was levied in Poland based on the Dutch-Polish double tax treaty. The withholding tax paid in Poland could not be credited in the Netherlands since the Fund is tax exempt there. On 3 December 2009, PwC Poland - acting as a proxy for the Dutch Pension Fund - submitted an application to the Head of the Tax Office in Warsaw asking for confirmation that: (a) the withholding tax on dividends earned by the Dutch Pension Fund was remitted unlawfully and the dividends should have been tax exempt in Poland; and (b) that Art. 6 sec. 1 point 11 of the CIT law, which exempts from taxation only Polish pension funds, is in breach of Article 63 TFEU.

The Head of Tax has now said that:

- the CIT exemption resulting from Art. 6 sec. 1 point 11 of the CIT Law only relates to Polish-based pension funds, that Polish tax laws should comply with EU law, and that Art.6 should be interpreted in accordance with Article 30 TFEU (former Article 12 EC Treaty), which prohibits discrimination on the basis of nationality;
- the Dutch Pension Fund is comparable to a Polish pension fund, i.e. it has conducted similar activities, acted on the market in a similar manner and offered similar services, and that Art. 6 sec. 1 point 11 CIT leads to discriminatory treatment of the Dutch Pension Fund, and an unjustifiable breach of Article 30 TFEU;
- (referring to the free movement of capital (Article 63 TFEU), the European Commission's Reasoned Opinion to Poland of May 2009 and the Polish reply agreeing with the EC's position) the dividends paid from Poland to the Dutch Pension Fund should have been exempted from withholding tax based on Art. 6 sec. 1 point 11 CIT interpreted in the light of Article 30 TFEU, and that the withholding tax remitted in Poland should be refunded to the Dutch Pension Fund.

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### **Portugal – Proposed State Budget for 2010**

The proposed State Budget for 2010 was presented to the Parliament for approval on 21 January 2010 and, among other measures, it introduced relevant changes to the Personal Income Tax (PIT) Code, including the standardisation of PIT withholding tax rates applicable to resident and non-resident individuals; the rate applicable for most types of income has been fixed at 20%, whereas in the past different rates were applicable depending on the nature of the income and on the qualification of the beneficiary (resident or non-resident).

The proposed State Budget also introduced relevant changes to the Corporate Income Tax (CIT) Code, including the extension, under certain conditions, of the CIT exemption under the

EU Directive 90/435/EEC (Parent-Subsidiary Directive) to dividends distributed by a Portuguese resident entity to an entity resident in an EEA country, to a PE in an EEA country of an entity resident in an EU Member State or in an EEA country, or to a PE located in an EU Member State of an entity resident in an EEA country.

Furthermore, the proposed State Budget has extended the regime to eliminate double taxation of profits (which allows a deduction from the taxable profit, under certain conditions, of 100% of dividends received or, if some conditions are not met, 50%) to dividends distributed to a PE located in Portugal of an entity resident in an EEA country and to dividends distributed to resident entities by entities resident in an EEA country. The referred regimes will only be extended to those EEA countries with which Portugal has reciprocity of tax information.

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### **United Kingdom – UK Court of Appeal decision on FII GLO**

On 23 February 2010, the UK Court of Appeal decision in *Test Claimants in the Franked Investment Group Litigation v HMRC* (the "FII GLO") was delivered. The case concerns the compatibility of the UK rules for the taxation of foreign dividends and advance corporation tax (ACT) with the Treaty on the Functioning of the European Union – TFEU (former EC Treaty). The High Court delivered its decision in November 2008 (see [EU Tax News Issue 2009 – nr 001](#)) but various aspects of that judgment were appealed.

The Court of Appeal judgment is long and complex and is very disappointing for taxpayers. Firstly, liability matters which had been decided in favour of the taxpayer in the High Court are now to be referred back to the ECJ, leading to further uncertainty and delay. Secondly, the Court of Appeal decision severely limits the remedies available to taxpayers, and this has wider implications for other EU litigation.

In its decision in December 2006, the ECJ had indicated that where a UK company received a dividend from an EU company in which it held 10% or more of the voting power, the UK tax charge on that dividend would be compatible with the freedom of establishment provisions of the TFEU provided that the level of and the rate of tax applied to the EU dividends was no higher than the rate of tax charged on UK dividends. The UK High Court interpreted the ECJ judgment as referring to the effective rate of tax, rather than the nominal rate of tax, and consequently concluded that this condition was not met and that the UK tax charge on EU dividends was therefore in breach of the freedom of establishment. However, the Court of Appeal does not agree with the High Court and considers that the matter should be referred back to the ECJ for clarification. The Court of Appeal judgment largely follows the High Court decision on other liability issues, with several matters to be referred to the ECJ.

There are two key points to note in relation to remedies. Firstly, the High Court had allowed common law claims for restitution of tax paid under a mistake of law, as opposed to claims for restitution of tax unlawfully demanded (often referred to as "Woolwich" claims) on the basis that there had been no formal demands for the tax. However, the Court of Appeal considers that a Woolwich claim is not limited to circumstances where there has been a formal demand

for tax, but can also apply in any case where tax had been unlawfully paid, including that paid under a self-assessment regime, and that taxpayers should therefore pursue Woolwich restitution claims rather than mistake claims. The extended time limit for a mistake claim is 6 years from the date the mistake was discovered (commonly the date of an ECJ judgment on the matter), but the time limit for a Woolwich claim is 6 years from the date of payment of the tax and has therefore already expired in most cases.

Secondly, the Court of Appeal has held that Taxes Act statutory mistake claims provide an exclusive remedy for claims for UK tax charged on EU dividends, i.e. that it is not possible to make common law restitution claims for this tax. This, however, does not appear to give an effective remedy, as statutory claims do not carry any entitlement to compound interest.

For those matters to be referred back to the ECJ, the Court of Appeal considers that the order for reference should be made by the High Court (such that the matter is subsequently referred back to the High Court), rather than the Court of Appeal. However, any order for reference to the ECJ may be delayed pending any application for permission to appeal against the Court of Appeal judgment to the Supreme Court. The claimants are considering whether to appeal.

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### **United Kingdom – ACT Class 2 and 4 GLOs – UK High Court decision**

On 26 February 2010 the UK High Court decision in *Test Claimants in the ACT Group Litigation (Class 4)/ Test Claimants in the ACT Group Litigation (Class 2) v HMRC* (the "ACT Class 2 and 4 GLOs") was delivered.

On 8 March 2001 the ECJ held in the *Hoechst - Metalgesellschaft* joined cases ([C-410/98](#) and C-397/98) that the inability of a UK subsidiary of an EU parent company to pay a dividend under a group income election (GIE), such that the UK subsidiary would be required to account for advance corporation tax (ACT) on the dividend, was a breach of the freedom of establishment under the Treaty on the Functioning of the European Union - TFEU (former EC Treaty). Following the ECJ judgment in *Hoechst* a number of taxpayers sought restitution of ACT paid in respect of dividends paid to foreign parent companies as a result of the inability to make a GIE. These claimants were brought together in the ACT group litigation order, which was split into several classes depending upon the status of the foreign parent company, the two classes relevant to the current case being Class 2 and Class 4.

Test claimants in the current case are parent companies resident in EU Member States (Netherlands and Italy) where the treaty with the UK gave entitlement to a partial tax credit on a dividend paid by a UK subsidiary. These treaties provide for a payment equal to half the tax credit to which a UK resident parent would be entitled, less 5% income tax on the aggregate of the half tax credit and the dividend. Where such a dividend was paid outside a GIE, the UK subsidiary was required to account for ACT on the dividend. The test claimants argued that in these circumstances:

- 1) the levy of ACT in excess of the partial treaty credit was in breach of EU law and sought restitution for the excess; or alternatively,
- 2) assuming that ACT is required to be paid in full and is not recoverable, that they should be entitled to restitution for the difference between a full credit and the partial treaty credit net of UK income tax.

The High Court held against the test claimants on both issues and did not consider that any further reference to the ECJ is necessary. Furthermore it held that, even if it had been possible to do so, the test claimants would not have made GIEs, such that their claims for restitution of the ACT should also be dismissed.

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### **United Kingdom – HMRC invites claims re 1.5% Stamp Duty Reserve Tax**

On 1 October 2009 the ECJ held in the case of *HSBC Holdings and Vidacos Nominees Ltd v HMRC* that the UK's 1.5% stamp duty reserve tax (SDRT) 'season ticket' charge on issuing new shares into a clearance service is contrary to EU law. Following that decision, on January 15, 2010, HM Revenue & Customs (HMRC) announced that it is inviting claims under statutory Taxes Acts procedures for the repayment of SDRT paid on the issue of shares in a UK incorporated company to a clearance service or depository receipt issuer located within the EU. Such claims are subject to a time limit of 6 years from the date of payment of the SDRT and attract statutory interest.

However, the HMRC announcement does not cover the following situations:

- 1.5% SDRT paid more than six years ago in respect of issues of shares into an EU clearance service;
- 1.5% SDRT paid in respect of issues of shares into non-EU authorised depositories;
- 1.5% SDRT paid on transfers of shares into either EU clearance services or non-EU authorised depositories;
- claims in respect of 1.5% stamp duty whenever paid; or
- where the claimant wishes to claim compound interest.

Taxpayers wishing to make such claims may need to make common law claims for restitution, although such claims must be made before 1 April 2010 (see item below) and may be dependent on a successful appeal of the FII GLO court of appeal judgment on remedies ([see](#)).

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### **United Kingdom – Pre-2004 transfer pricing rules**

Further to the UK High Court's decision of 17 November 2009 in the *Thin Cap GLO*, which concerned the UK's pre-2004 thin capitalisation regime, Tax Counsel has advised that there are very good arguments that the pre-2004 transfer pricing legislation also represented a restriction on freedom of establishment and as such should not be applied to wholly

commercial transactions. Companies which have suffered additional tax as a result of the application of the pre-2004 transfer pricing rules may have a limited window of opportunity to make claims before 1 April 2010 (see below).

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### **United Kingdom – Last chance to make common law EU Treaty claims for repayment of direct tax**

With effect from 1 April 2010 (irrespective of the outcome of the FII GLO litigation) it will no longer be possible to make common law claims for restitution of direct taxes paid under a mistake of law. These claims are often made to obtain repayment of UK direct taxes (corporation tax, income tax, capital gains tax) paid in breach of EU Law. There is therefore one final chance for taxpayers (companies, individuals or trusts) to identify and make such claims before 1 April 2010.

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## EU DEVELOPMENTS

### EU – EC Direct tax policy-making in 2010

The new European Commission was endorsed by the European Parliament on 9 February 2010 and EU Tax Commissioner, Algirdas Semeta, will have to set his policy priorities for the next five years (see next item below). During his parliamentary approval hearing he said he is in favour of CCCTB and tax harmonisation and closing “the loopholes on taxation”. DG TAXUD, which Semeta formally heads, is expected to release a strategic paper on “EU direct tax policy in a post-crisis world” by mid-2010.

With most EU Member States still in recession, and given the huge bailouts provided in 2008 and 2009 to the banking and automobile sectors across Europe, reducing the sky-rocketing national public debt while still fostering economic growth will be the key policy drivers for governments for years to come, and, for that matter for the EU. The financial crisis and the host of unilateral reactions it triggered in European capitals turned out to be an almost existential test for European integration, in particular the Single Market and the role of the Commission as the guardian of the Treaties. As a direct result of the crisis, the Commission is now obliged to conduct an internal economic impact assessment for each new EC proposal before it can be adopted.

Adding to the perceived general corrosion of the Commission's power has been the advance since 1995 of the Council's (the Member States) decision-making powers vis-à-vis the Commission in many EU policy areas. An often heard critique in Brussels is that “Barroso I” has lost way too much influence to the Council in large part due to its preoccupation with President Barroso's re-election, that is, trying to placate as many Member States as possible, notably the important ones, on all types of EU policy. However, in October 2009, President Barroso announced that former EU Commissioner Mario Monti had agreed to prepare a (external) report for the Commission by April 2010 to re-launch the Single Market as a key strategic objective of the new Commission. The report will also look at taxation. Monti said before that full tax harmonisation is neither feasible nor really necessary.

And then there is also the European Parliament in the equation with its structural quest to increase its own powers versus the Council and Commission's on account of “reducing the democratic deficit” in EU decision-making. For his re-election and acceptance of his new Commission, President Barroso has required the support of the Parliament, which has its price. After a recent deal struck by the EC President and European Parliament leaders, the Parliament is from now on to be consulted on every EC proposal with a ‘regulatory implication’ which includes ‘soft law’ on direct taxation as well. The Lisbon Treaty has given the Parliament a greater say in decision-making in general and it is testing its powers regarding the Commission.

There is also the failure of the EC's 2010 Lisbon Strategy to make Europe the most competitive and high-tech economic player in the world by 2010. The Commission has simply launched a successor strategy, the EC's 2020 Lisbon Strategy towards a green and innovative economy, which has a big fiscal component.

As a result of this, EC policymaking in the field of direct taxation and fiscal aid has become much more complicated than before. In a separate parallel development, the OECD has become relatively more prominent in tangentially co-shaping the EU's direct tax policy framework. This is demonstrated by the debate on, for example, business restructurings, allocating business profits and dispute resolution. It remains to be seen whether the Commission can regain some lost ground in 2010.

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## **EU – New EU Tax Commissioner Šemeta unveils his work programme**

New EU Tax Commissioner Šemeta presented his three-pronged work programme to EU finance ministers at the ECOFIN Council held on 16 February 2010.

### *1. Exit strategy out of the crisis*

Tax policy cannot be absent in any credible exit strategy and improving tax policy coordination could play a fundamental role as part of a broader framework of overall economic policy coordination. Besides ensuring the necessary levels of tax revenue, meeting budgetary needs and supporting growth strategies minimising the burden on citizens and businesses will be important. Furthermore, he is committed to tackling tax evasion, avoidance and harmful tax competition at EU and international level by promoting good governance (transparency, exchange of information and fair tax competition) in the tax area. He welcomed the G-20 conclusions on uncooperative jurisdictions and banking secrecy. Mr Šemeta said he was also looking at 3 possible tax initiatives for supporting innovative global financing solutions. Tax systems should also contribute to fostering long-term sustainable growth and employment.

### *2. EU 2020: A single market for growth*

Europe needs to boost competitiveness and growth as a core priority and the proper functioning of the internal market is a key element of the EC's 2020 strategy towards a green and innovative economy. (This grand new strategy was announced by the Commission on 3 March 2010.) Reducing administrative burdens and simplification of the rules, both in the direct and indirect tax areas, is essential for enabling European economic actors to unleash their full potential in the internal market. Mr Šemeta wants to work further on the concept of a CCCTB with a view to finding solutions for problems pertaining to cross-border double taxation, loss relief and transfer pricing within the EU. Improving the EU's VAT system and organising a public consultation on double taxation of citizens in cross-border situations are also action points.

Mr Šemeta said he was anticipating in particular the recommendations from former EU Commissioner Monti on tax policy as part of his report on the re-launch of the single market. The Monti report is expected by the end of April. At the EC's Brussels tax forum on 1 March 2010, Mr Monti gave a sneak preview of his report where he reiterated that full tax harmonisation is not feasible nor really necessary. However, at the same time he stressed that any bold re-launch of the single market would not be credible without more tax cooperation and coordination between member states than is the case today. Consequently, a frank, open and pragmatic discussion between the EU member states on tax policy is absolutely necessary. He

referred to the process of the adoption of the EU's 1997 Tax Package as a best practice example, whereby gradually deepening personal relationships, mutual understanding and respect for sensitivities among EU Finance Ministers culminated in concrete results and an agreement. Mr Monti will furthermore recommend a robust EU advocacy strategy, to be propagated by Europe's leaders, in order to much better explain and promote the important achievements and wider benefits of the single market in the fields of social, enterprise, industrial and tax policy, as well as the external dimension of the single market, and which should thus not be merely limited to highlighting economic efficiency aspects.

### *3. Leading on climate change*

Lastly, Mr Šemeta wants to enshrine the principles of environmental protection and energy efficiency in Europe's economy. Taxing CO<sub>2</sub> in sectors not covered by the EU emission trading system would be a cost-effective way to meet the EU's commitments under the climate change package and to transform to a low carbon economy. As a first step, he proposed a revision of energy taxation addressing both the CO<sub>2</sub> price signal and energy efficiency.

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## **Belgium – European Commission issues two reasoned opinions to Belgium concerning investment funds, including real estate SICAFs**

On 28 January 2010, the European Commission announced it had formally requested Belgium to change its tax provisions which result in a higher tax burden on dividends and interest paid to foreign investment funds compared to similar payments made to domestic investment funds. The request took the form of a Reasoned Opinion (second step of the EU's infringement proceedings under Article 258 of the Treaty on the Functioning of the EU - TFEU (former Article 226 EC Treaty). At the Commission's request, the Belgian Government has changed the law which entered into force on 22 February 2010: see item [above](#)).

On the same day, the European Commission announced that it has sent a second reasoned opinion to Belgium over the taxation of dividends received from Belgian investment funds investing all of their assets in real estate (real estate SICAFs). Belgium limits the exemption from withholding tax to dividends paid by Belgian "real estate" SICAFs investing at least 60% of their assets in residential real estate in Belgium, which according to the Commission results in discriminatory treatment. Under articles 2, 1°, of the Royal Decree of 10 April 1995 on Belgian "real estate" SICAFs and article 106 §8 of the Royal Decree implementing the Belgian tax code dividends paid by Belgian "real estate" SICAFs investing at least 60% of their assets in real estate situated in Belgium are exempt from withholding tax in the hands of resident shareholders, whereas dividends paid by their foreign counterparts are not. The Commission considers this treatment discriminatory and an obstacle to the free movement of capital and the freedom to provide services as laid down in the TFEU and the EEA Agreement, since such a rule creates an incentive for Belgian residents to only invest in Belgian real estate investment funds. Moreover, the rule that Belgian investment funds investing in real estate have to invest at least 60% of their assets in real estate situated in Belgium in order to benefit from the exemption also constitutes a restriction to the free movement of capital and the freedom to provide services, as it dissuades Belgian investment funds from investing in real estate situated abroad. If there is no satisfactory reaction to the reasoned opinion within two months,

the Commission may decide to refer the matter to the ECJ. The EC's case reference number is 2008/4156.

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### **Greece – European Commission acts against Greece over taxation of income from inbound dividends**

The European Commission announced on 28 January 2010 that despite a 2009 ECJ judgment, Greece has not communicated any changes to its legislation relating to the taxation of income from inbound dividends paid to individuals. Under Greek law, dividends from non-Greek companies are subject to income taxation in Greece, whereas dividends from domestic companies are exempted from tax. The Commission referred the case to the ECJ, which, in *Commission v. Greece* (C-406/07 of 23 April 2009), declared that by applying a tax regime for dividends from abroad that is less favourable than that applied to domestic dividends, the Hellenic Republic has failed to fulfil its obligations under Articles 49 and 63 of the Treaty on the Functioning of the European Union – TFEU (former Articles 43 and 56 EC Treaty) and the corresponding articles of the EEA Agreement. To date the Greek authorities have not formally communicated any amendments to the legislation at issue to the Commission. If Greece fails to comply with the letter of formal notice, the Commission may refer the case to the ECJ again in order to agree the imposition of a lump sum or penalty payment on Greece. The Commission's case reference number is 2006/4044.

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### **Spain – European Commission formally requests Spain to amend certain rules related to the appointment of fiscal representatives**

On 28 January 2010, the European Commission announced it had formally requested Spain to change its tax provisions related to the appointment of fiscal representatives. The Commission considers that the rules which require certain non-resident natural and legal persons to appoint a fiscal representative in Spain result in discriminatory treatment. The request takes the form of a reasoned opinion. Under Spanish law, foreign pension funds located in Member States other than Spain and providing for occupational pension schemes in Spain; EU insurance companies operating in Spain under the freedom to provide services; non-resident companies operating in Spain through a PE; and non-resident natural persons subject to inheritance and gift tax in Spain, are obliged to appoint a resident tax representative in Spain. The Commission considers that this requirement is not proportionate and that it restricts the free provision of services. If there is no satisfactory reaction to the reasoned opinion within two months, the Commission may decide to refer the matter to the ECJ. The Commission's case reference number is 2007/2446.

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## **Spain – European Commission formally requests Spain to abolish its transfer tax on certain contributions of capital**

On 28 January 2010, the European Commission announced it had formally requested Spain to change its tax provisions related to the transfer of securities. The Commission considers that the imposition of a transfer tax on certain contributions of capital, in addition to capital duty, is contrary to the Capital Duty Directive (2008/7/EC). The request takes the form of a reasoned opinion. According to article 108 of Law 24/1988 of 28 July 1988 on the securities market, in case of a contribution of capital to a company whose real estate assets located in Spain represent more than 50% of its total assets or whose assets include securities in another entity whose assets consist as to at least 50% of real estate located in Spain, any contributor who as a result of this contribution obtains a position such as to exercise control over this entity or, once this control has been obtained, increases his shareholding in the entity, will have to pay a transfer tax (at a tax rate which ranges from 6 to 7%) in addition to the capital duty (1%) paid by the company increasing its capital. Council Directive 2008/7/EC allows Member States to levy capital duty on contributions of capital but the tax rate may not, in any event, exceed 1% of the capital increase and, according to article 5 of the Directive, Member States may not levy any other tax on such an increase. The Commission considers that the Spanish legislation at issue is not in line with article 5 of the Directive as it provides for another tax to be levied in addition to capital duty on certain contributions of capital that fall within the scope of the Directive. If there is no satisfactory reaction to the reasoned opinion within two months, the Commission may decide to refer the matter to the ECJ. The Commission's case reference number is 2008/4760.

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## STATE AID

### **Germany – European Commission opens in-depth investigation (State aid) on loss carry forward for ailing companies**

According to the German change of control rule (Sec. 8c CITA) a loss carry forward of a German corporation will be forfeited partially/wholly when the ownership of the share capital changes as to more than 25-50% within a period of five years. As an exception to this rule, the loss can be carried forward in cases where the change of ownership pursues a financial restructuring (*Sanierungsklausel*). Such a financial restructuring has to fulfil several requirements like clearing or avoiding insolvency while maintaining the substantial business organisation which in turn underlies a specific definition. The *Sanierungsklausel* has been adopted by the German legislator in 2009 with retroactive effect for restructurings (transfer of shares) conducted after 31 December 2007.

On 24 February 2010, the Commission published a press release (IP/10/180) according to which it doubts whether this exception is in line with the EU's principles of State aid and therefore announces the opening of an in-depth investigation. In the Commission's view, the measure seems to be selective, as it differentiates between ailing companies and healthy companies. Indeed, both companies could be loss making, but only the former are eligible for the carry forward of such losses under the *Sanierungsklausel*. The Commission is of the opinion that the German authorities have not provided sufficient arguments that would lead to the conclusion that the *Sanierungsklausel* is justified by the nature and general scheme of the German tax system. The German authorities, however, consider that this measure does not fall under the State aid rules and have not notified the *Sanierungsklausel* to the Commission before it came into effect.

If the Commission considered the *Sanierungsklausel* to be unlawful State aid, an already provided tax relief by granting a loss carry forward would have to be refunded. However, such a decision of the Commission could be challenged within two months with an action for annulment with the Court of First Instance. The decision could be challenged by the German Government and possibly also by an aid recipient if they fulfil the requirement to be directly and individually concerned and have a sufficient legal interest. See also EUDTG [Newsalert 2010 – nr 003](#).

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### **Italy – Italy appeals to the ECJ against CFI judgment on Italian measure favouring newly listed companies**

Italy has brought to ECJ an appeal against the CFI's judgment, delivered on 4 September 2009, in which it rejected Italy's request for the annulment of the European Commission's Decision regarding an aid granted to certain newly listed companies (case [T-211/05](#)). See also: [EU Tax News 2009 - nr. 006](#).

The measure under scrutiny, laid down in sections 1 and 11 of the Legislative Decree Nr. 269 of 2003 (came into effect on 2 October 2003), provided that the companies whose shares were admitted to trading on a regulated market between the date of the entry into force of the Legislative Decree and 31 December 2004 could be entitled to:

- A reduced income tax-rate of 20% (instead of the ordinary 33% tax-rate then in force), for the year of admission to trading and for the two subsequent tax years, if certain requirements were met. The maximum net taxable income to which the reduced rate was applicable was EUR 30 m; and
- A *de facto* double deduction of the admission to trading costs.

By means of EC Decision Nr. 2006/261/EC of 16 March 2005, the Commission declared that the measure was State aid within the meaning of Article 107 (1) of the Treaty on the Functioning of the European Union – TFEU (former Art. 87(1) EC Treaty), and thus incompatible with the common market. In addition, as the measure had not been notified before its implementation, the Commission also ordered the recovery of the illegal aid from the (ten) beneficiaries, which was estimated at roughly EUR 11.7 m for each beneficiary.

Italy decided to submit a further appeal against the CFI's judgment before the ECJ mainly based on the following:

- Infringement of Article 87(1) EC (now Article 107(1) TFEU). According to Italy, the measure is of general application and non-selective for the following reasons. Firstly, the measure is available to all companies which meet the requirements for being listed on an EU regulated market. The fact that Italian companies reap a greater benefit is a consequence of the tax system, which provides that the taxation is to be based on the criterion of residence but is not of relevance for deciding the selective nature of the measure. Secondly, the choice to grant the advantage only to newly listed companies and not also to non-listed companies is not selective, because the latter is based on and consistent with the different situation, in term of structural costs, in which the two categories of company are placed. Thirdly, the temporary nature of the tax relief is not selective because it can be explained by the need for budget balances and the experimental nature of the measure and it has not to be evaluated as an element to establish the selective nature of the same as the CFI did;
- Infringement of Article 87(3)(c) EC (now Article 107(3)(c) TFEU). Failure to state adequate reasons. The measure, even if it may be regarded as State aid, is compatible with the common market under Article 87(3)(c) EC, since it constitutes an investment aid to facilitate the development of certain economic activities. According to Italy, the CFI erred in regarding the measure as operating aid.

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