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TAXeNEWS Europe

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ECJ CASES

Austria – ECJ referral regarding discriminatory tax provisions related to the appointment of fiscal representatives

The European Commission referred Austria to the ECJ on 3 June 2010 for its discriminatory provisions related to the appointment of fiscal representatives.

Under Austrian law, foreign investment funds and real estate funds must always appoint a fiscal representative when carrying out operations in Austria, whereas Austrian funds are not required to do so. In addition, foreign credit institutions managing domestic investment funds or real estate funds must also appoint a fiscal representative while domestic credit institutions managing domestic investment funds or real estate funds are exempted from this requirement. Furthermore, since only domestic credit institutions or domestic certified public accountants can be appointed as fiscal representatives, foreign credit institutions and foreign certified public accountants are being discriminated against. This restriction of the freedom to provide services constitutes direct discrimination based on the place of establishment of service providers.

The Commission considers that these rules result in a discriminatory treatment. The Commission is also of the opinion that the prohibition for foreign credit institutions and certified public accountants to be appointed as fiscal representatives for investors in investment funds or real estate funds is not in line with EU Law and therefore incompatible with the freedom to provide services.

As Austria failed to comply with the Commission's request to amend the discriminatory provisions, Austria was referred to the ECJ; EC case reference number: 2008/4638.

-- Richard Jerabek and Verena Pulling, Austria; richard.jerabek@at.pwc.com

Belgium – ECJ referral regarding discriminatory taxation of interest paid by foreign banks to individuals

According to article 21, 5° of the Belgian Income Tax Code, interest arising from a savings deposit up to an amount of EUR 1.660 per year (subject to an annual indexation) is not considered movable income subject to Belgian taxation provided amongst other conditions, that the interest is the result of a savings deposit held at a financial institution located in Belgium.

On 25 June 2009, the European Commission sent Belgium a formal request to amend this legal provision considering that the exemption is not applicable to interest income resulting from savings deposits held at financial institutions located outside Belgium. The Commission therefore opined that the difference in treatment of interest income resulting from savings deposits depending on where the paying financial institution is located violates the free movement of capital and freedom to provide services.

Since Belgium failed to comply with the Commission's request, the Commission referred Belgium to the ECJ on 5 May 2010. EC Case reference number: 2008/4624.

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

Finland – ECJ referral for failure to amend discrimination against foreign pension funds

The European Commission has decided to refer the case of Finnish taxation of dividends distributed to pension funds to the ECJ.

In Finland, dividends paid by a resident company to a non-resident pension fund are subject to a withholding tax on gross income at a rate of 19,5%. However, Finnish pension institutions, i.e. pension insurance companies and pension funds (in Finnish "eläkesäätiö / eläkekassa") are taxed on 75% of dividend income regarded as "investment assets". Since the nominal corporate income tax rate is 26%, the tax rate for dividends paid to Finnish pension funds is 19,5% but the tax is calculated on the net income, i.e. after deduction of costs and current pension liabilities. In practice, the effective tax rate on dividend income paid to a Finnish pension fund will be lower than 19,5% while foreign pension funds cannot benefit from a reduction of the tax base on which the withholding tax is applied.

Since May 2007, the Commission has started and pursued infringement procedures against 16 EU Member States for their discriminatory taxation of dividend and interest payments to foreign EU pension funds. These Member States have either already aligned their legislation or have promised to do so, are still negotiating with the Commission or are now facing an ECJ referral. EC Case reference number: 2006/4096.

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Germany – ECJ referral for discriminatory taxation of foreign pension funds

On 3 June 2010, further to its formal notice of 31 January 2008 (see also EUDTG Newsalert 2008 - 006) and its reasoned opinion of 29 October 2009 (see EUDTG Newsflash 2009 - 038), the European Commission published its decision to refer Germany to the ECJ for not amending its legislation as required.

The referral deals with Germany's rules on taxation of dividend (and certain interest) payments to foreign resident "Pensionskassen" and "Pensionsfonds" established in the EU and the EEA.

As to "Pensionskassen", dividends paid by German companies to German "Pensionskassen" are subject to a reduced withholding tax rate of 15.8%. However, foreign resident institutions are subject to a final withholding tax of 26.4 % (if no double tax treaty is applicable).

Dividends received by German "Pensionsfonds" are taken into account in the annual tax assessment and are taxed on a net basis after mainly deducting premium reserves at the general tax rate of 15.8 %. However, dividends paid to foreign institutions are subject to a

final withholding tax of 26.4 % (if no double tax treaty is applicable) on the gross dividend, without the possibility to deduct any costs.

A similar distinction is made for certain interest payments.

The Commission is of the view 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 63 TFEU and Article 40 EEA. The Commission is not aware of any justification for such restrictions.

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Italy – ECJ judgment on compatibility of Italian tax provisions on the deductibility of tuition fees paid by individuals: Zanotti case (C-56/09)

On 20 May 2010, the ECJ passed judgment regarding the compatibility with EU Law of the Italian tax provisions on the deductibility of the tuition fees paid by individuals.

The legislation at hand is laid down in section 15, paragraph 1, let. e) of the Italian Tax Code, which provides that, up to 19%, the tuition fees paid by an individual, can be deducted from the total amount of the taxes due.

As clarified by the Italian Tax Authorities by means of the Circular letter dated 12 May 2000, Nr. 95, the aforementioned tax provision is also applicable to courses attended at foreign or Italian private schools. However, in such cases the 19% deduction has to be calculated on the amount which would have been paid for similar courses attended, respectively, at:

- Italian public school nearest the Italian city of residence, for tax purposes, of the individual (foreign courses);
- Italian public school nearest the city of the Italian private school (Italian private courses).

The ECJ held that the Italian tax provisions would be in breach of EU Law if the right to deduct the costs of attending courses abroad was denied, while, at the same time, the deduction of the costs of attending Italian courses was permitted.

According to the ECJ, in respect of the deduction of tuition fees similar tax rules apply to courses attended at italian private schools or foreign private schools. Depending on the place of the private school chosen in Italy, the amount of deductible costs would have been more or less than the amount calculated by reference to the costs of attending a similar course in an Italian public school nearest to the city of the individual's residence for tax purposes.

Accordingly, for the ECJ, the Italian tax provisions do not dissuade individuals resident in Italy from attending courses at private schoolssituated in other EU Member States.

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Netherlands – ECJ judgment on the application of the anti-abuse provision in the Merger Directive: Zwijnenburg case (C-352/08)

On 20 May 2010, the ECJ passed judgment regarding the application of the anti-abuse provision pursuant to Article 11, par 1, a, of Council Directive 90/434/EEC of 23 July 1990 (Merger Directive).

The Dutch clothing company Modehuis A Zwijnenburg BV ("Zwijnenburg") operated a shop in two premises. Zwijnenburg was the owner of one of the 2 premises. Zwijnenburg Beheer BV ("Beheer") owned the other and had as its sole activity the management of real property. The shares in Beheer were held by the parents of the son who held the shares in Zwijnenburg.

In order to complete the transfer of the parents' business to the son it had been envisaged that Zwijnenburg would transfer its clothes business and premise in return for shares in Beheer. As a result the business and both premises would be in one single legal entity (Beheer). Pursuant to Dutch law incorporating the Merger Directive, that company merger was to be exempt from tax. At a subsequent stage, Zwijnenburg was to purchase the remaining shares in Beheer, which belonged to the parents and were accompanied by a purchase option. In this way, the imposition of transfer tax on the real property was avoided.

The tax administration held the view that the choice for a company-merger to bring the business and both premises together was not motivated by commercial reasons within the meaning of Article 11, par 1, a, of Council Directive 90/434/EEC, since Zwijnenburg was to transfer its business to Beheer and was subsequently to acquire the shares issued by Beheer, with the sole purpose of avoiding transfer tax. As a consequence, the tax administration refused to apply the benefits of the Merger Directive.

The ECJ ruled in favour of the taxpayer: the avoidance of a tax to which the Merger Directive does not apply does not in itself constitute sufficient reason for a Member State to refuse the benefits of the Merger Directive. The Merger Directive's anti-abuse provision could not be applied.

Thus, the judgment stresses that the benefits of the Merger Directive have to be applied, save for wholly artificial arrangements in specific cases aimed at circumventing the taxes covered by that Directive.

-- Sjoerd Douma and Anna Gunn, Netherlands; sjoerd.douma@nl.pwc.com

Portugal – AG opinion on special regime for the tax adjustment of financial assets outside Portugal with the free movement of capital: Commission v Portugal (Case C-20/09)

On 17 June 2010, AG Mengozzi issued his opinion in Case C-20/09. The subject of the Commission application was the Portuguese Extraordinary Scheme for the tax adjustment of financial assets not situated within Portuguese territory on 31 December 2004 (RERT), approved by Law No 39-A/2005. Under this regime, taxpayers holding undeclared pecuniary items abroad on 31 December 2004 were allowed to disclose and regularise such investments by filing a confidential tax statement until 16 December 2005 and pay a sum corresponding to the application of a rate of 5% on the value of the financial assets listed in such declaration. However, a preferential reduced rate of 2.5% would be applied if the declared financial assets were Portuguese government bonds or if their respective value had been reinvested in Portuguese government bonds by the time when the adjustment declaration was filed.

The Commission submitted that the regime in question, which expired on 31 December 2005, was more favourable to taxpayers who invested in Portuguese government bonds and dissuaded taxpayers from keeping their regularised financial assets in forms other than Portuguese State securities. According to the Commission, such a difference in treatment constituted a breach of EU Law, namely of the free movement of capital enshrined in Article 56 of the EC Treaty (now Article 63 of the Treaty on the Functioning of the European Union) and of the corresponding Article 40 of the EEA Agreement.

The AG followed the Commission and opined that the Portuguese regime constitutes a discriminatory restriction on the free movement of capital within the EU, that cannot be justified by the need to prevent tax fraud or tax evasion.

If, as expected, the ECJ follows the AG, Portugal will have to rectify its position and may have to refund 2.5% on the value of the financial assets declared by taxpayers under the Extraordinary Scheme for the tax adjustment of financial assets not situated within the Portuguese territory on 31 December 2004, as this regime may be considered incompatible with EU Law. Portugal may be compelled to reimburse taxpayers who have not benefited from the reduced tax rate provided for in the regime.

A similar regime has been introduced in 2010 in Portugal, by which undeclared financial assets located outside the EU/EEA may only be regularised if and when they are repatriated to Portugal, but not if they are repatriated to other EU or EEA countries. This regime may also raise issues of EU Law compatibility.

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Portugal – ECJ judgment on taxation of interest payments to non-resident financial institutions: Commission v. Portugal (C-105/08)

On 17 June 2010, the ECJ handed down its decision brought by the European Commission against Portugal on 6 March 2008. In its application, the Commission submits that interest paid to non-resident financial and credit institutions is subject to a far heavier tax burden than similar income paid to resident taxpayers.

Under Portuguese legislation, interest received by non-resident financial and credit institutions is subject to a withholding tax rate up to 20%, levied on the gross amount of income, whereas resident taxpayers are taxed at the general rate of 25% on their net income, as they are allowed to deduct from the amount of their taxable income the operating expenses directly connected with the activity pursued.

The Commission considers that this difference in treatment constitutes an infringement of EU Law, namely of the freedom to provide services enshrined in Articles 56 and 63 of the EC Treaty and the corresponding Articles 36 and 40 of the EEA Agreement.

The ECJ, following the Opinion issued by AG Kokott on 25 March 2010, concluded that the Commission failed to produce conclusive evidence and demonstrate that the Portuguese legislation leads to a higher taxation of non-resident financial institutions, as it relies on mere assumptions. For more information on this matter, please refer to our EUDTG Newsflash 2010 - 024.
-- Leendert Verschoor en Jorge Figueiredo; Portugal; leendert.verschoor@pt.pwc.com

Portugal – ECJ referral for discriminatory taxation of outbound dividends: Commission v. Portugal

On 3 June 2010, the European Commission decided to refer Portugal to the ECJ for its tax rules under which certain dividend payments to non-resident entities may be taxed more heavily than payment of dividends to resident entities.

According to the Portuguese corporate income tax code, dividend payments to resident entities are subject to a 20% withholding tax rate (the rate was increased to 21.5% per 1 July 2010). This withholding tax has a mere nature of a payment on account. Also, according to specific double economic taxation rules, the receiving entity is entitled, under certain conditions, to deduct 100% (or only 50%) of the dividends received from its annual taxable profit in order to compute the final tax due.

On the other hand, dividend payments to non-resident entities are subject to a 20% withholding tax rate. This withholding tax can be reduced or eliminated under the EU Parent-Subsidiary Directive or under the application of a Double Tax Treaty, if certain requirements are met. However, the parent company's state of residence may or may not allow the deduction of the dividends from the taxable profit or give a tax credit for the withholding tax levied at the source state. Nonetheless, the approach taken by the EC followed the EFTA

court in the Fokus Bank case (Case E-1/04), where it was ruled that it is not relevant whether a tax credit is given in the parent company's state.

The Commission considers that this difference in treatment may lead to a higher taxation of dividends paid to non-resident entities, and therefore, it constitutes an infringement of the free movement of capital and the freedom of establishment as foreseen in the EC Treaty and in the EEA Agreement.

In the Denkavit ruling of 14 December 2006 (Case C-170/05), the ECJ confirmed the principle that outbound dividends cannot be subject to higher taxation in the source state than domestic dividends. However, the ECJ has followed an approach different from the one followed in the Fokus Bank case, stating that it may be relevant to take into account whether the State of residence of the parent company gives a tax credit for the withholding tax levied by the source State.

The Commission had already decided to refer Portugal to the ECJ in December 2006. Further to a request from the Commission, Portugal amended its tax rules. However, on 14 April 2009, dissatisfied with the amendments made by Portugal, the Commission sent a Reasoned Opinion to Portugal. As Portugal refused to make any new amendments, the Commission decided to refer Portugal to the ECJ. The Commission's case reference number is 2004/4353.

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Spain – ECJ judgment on different taxation of dividends distributed by Spanish companies to resident and non-resident parent companies: Commission v. Spain (C-487/08**)**

On 3 June 2010, the ECJ ruled that making the exemption of dividends distributed by companies resident in Spain subject to a higher minimum holding percentage for recipient companies resident in another EU Member State than for recipient companies resident in Spain, is contrary to the former Article 56 EC (now: Article 63 of the Treaty on the Functioning of the European Union).

Under Spanish legislation, dividends distributed by a company resident in Spain to another company resident in Spain which has held for a continuous period of at least one year, a direct or indirect shareholding of 5% or more in the distributing company, may be deducted in full from the taxable income of the recipient company and are, in addition, exempt from withholding tax. However, as regards the dividends distributed by a company resident in Spain to a company resident in another Member State, they are exempt only where the recipient company had a direct shareholding of at least 10% (15% until 31 December 2008 and 20% until 31 December 2006).

In its case law, the ECJ has clearly established that it is in principle contrary to EU Law (to the rules on free movement of persons and free movement of capital) to treat tax residents and non-residents differently, where there is no objective difference between them.

In its case law, the ECJ has also clearly established residents and non-residents are comparable when, in a Member State, both of them are subject to tax on dividends received from resident companies.

According to this decision, non-resident shareholders that have suffered Spanish withholding taxes on dividends distributed by companies resident in Spain, while having a participation of 5% or more in the distributing company, but less than 10% (15% until 31 December 2008 and 20% until 31 December 2006), should consider claiming a refund from the Spanish Tax Authorities, provided that request is made within the applicable statutory time limits.

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NATIONAL DEVELOPMENTS

Finland – Finnish tax administration issues guidelines post Supreme Administrative Court's decision in the Aberdeen case

The Finnish Tax Administration has published guidelines (n:o 665/37/2010 published 24.6.2010) on how to apply the Finnish Supreme Administrative Court's decision in the so-called Aberdeen case (SAC 2010:15).

According to the guidelines and in line with the 1.1.2009 amended Withholding Tax Act non-Finnish EU- or EEA-resident (excluding Liechtenstein) recipient of a Finnish source dividend should not be taxed in Finland provided that: 1) similar intra-Finnish dividend would be tax exempt, and 2) Finnish withholding tax is not fully credited in the country of the recipient on the basis of an applicable tax treaty.

The guidelines do not provide specific answers to the questions that remained after the Withholding Tax Act was reformed as of 1.1.2009. One of these questions was whether Luxembourg SICAV (UCITS-fund) could be comparable to a Finnish investment fund (UCITS-fund). The ECJ did not investigate this question in the case C-303/07, *Aberdeen*, as under the specific circumstances at hand in the *Aberdeen* case this comparison was not necessary. Therefore, the most typical situation where a non-listed Luxembourg SICAV (UCITS-fund) invests in Finnish quoted shares and receives dividends is still unsolved. If a Luxembourg SICAV is compared to a Finnish limited liability company, intra-Finnish dividend is taxable in the hands of the Finnish recipient and there seems to be no discrimination. On the other hand, if a Luxembourg SICAV is comparable to a Finnish investment fund, intra-Finnish dividend is tax exempt and discrimination seems to be evident. The guidelines specifically mention that in the Aberdeen case (and subsequent SAC 2010:15 decision) the comparability of a Luxembourg SICAV to a Finnish investment fund was not analyzed and that the SICAV in question in Aberdeen was not an UCITS. Therefore it is stated that the *Aberdeen*-case (and subsequent SAC 2010:15) have no impact on dividends paid to foreign investment funds.

After the ECJ´s *Aberdeen*-case the Finnish Withholding Tax Act has been reformed, the Finnish SAC has given its final decision in *Aberdeen* and now the Finnish tax authorities have published their guidelines. Even after all of these, there are still uncertainties as to whether the current Finnish tax law and tax practice is in line with the EC Treaty.

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Finland – Central Tax Board advance ruling on withholding tax on dividends from a Finnish listed company to a Luxembourg insurance company (S.A.)

The Finnish Central Tax Board has given an advance ruling concerning a Luxembourg registered insurance company (S.A.) and the withholding taxation of dividends received from a Finnish quoted company. The shares of the Finnish quoted company were a part of the Luxembourg company's investment assets and formed less than 10 per cent of the limited liability company's capital.

According to the Finnish Withholding Tax Act, the withholding tax of 19,5% on the gross amount of the dividend should be levied on the insurance company in question. The legislation in Luxembourg does not consider the dividends as taxable income thus the withholding tax cannot be credited in Luxembourg.

Comparable intra-Finnish dividends are taxable income at the hands of a Finnish resident recipient (75% of the gross dividend taxable at the rate of 26%, i.e. statutory tax rate 19,5%). However, Finnish insurance companies are entitled to specific deductions on the basis of their increased insurance liabilities. Therefore, they do not typically pay the full amount (19,5% on the gross dividend) of taxes on the dividends received.

The Central Tax Board did not consider the deduction on the basis of the increased insurance liabilities to be directly linked with the dividend income and therefore did not consider that the deduction should be granted to a non-Finnish insurance company as well. The Central Tax Board decision may still be appealed to the Finnish Supreme Administrative Court and referred further to the ECJ. This case has similar features with the Finnish tax system regarding dividend payments to pension funds. With respect to pension funds, Finland has ready been referred to the ECJ as the EU Commission considers the Finnish taxation to be in breach of the EC Treaty.

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Germany – Oral hearing at Federal Fiscal Court re final foreign PE losses

On 9 June 2010, two oral hearings at the Federal Fiscal Court (BFH) took place, both dealing with (final) losses of French permanent establishments (PE) of German enterprises.

(1) In the first case (I R 100/09), French PE losses of 1999 were forfeited in 2004, as France only provided for a loss carry-forward of 5 years. The plaintiff claimed for a loss deduction in Germany in the fiscal year 1999. The PE was closed in 2005 (after the 5 year period of the loss carry-forward).

In the (preliminary) view of the presiding judge, as expressed during the hearing, the ECJ judgment in the case *Krankenheim* (C-157/07) might serve as a guidance to solve this case. As the use of losses was restricted by French tax law, Germany would not be obliged to import such losses. The judge declared such a loss restriction as a *restriction by juridical means* of the Source State which should not affect the taxation of the Home State.
On 10 June 2010, the BFH announced the operative provision (guideline) of its judgment according to which the appeal will be dismissed. This confirms that our understanding as described above is correct: a loss-forfeiture due to time limitations in the Source State does not lead to *final* losses in the meaning of *Lidl Belgium.*

(2) In the second case (I R 107/09), French PE losses of 2000 and 2001 could not be used anymore, because the PE was closed in 2001 (within the 5 year period of the loss carry-

forward). The plaintiff claimed for a loss deduction in Germany in the fiscal year 2000 and 2001.

The presiding judge seemed to accept that this case fulfils the requirements of *final* losses in the meaning of the *Lidl Belgium* decision (C-414/06) which need to be considered in Germany. The judge declared such a loss restriction as a *restriction by factual means* which should eventually affect the taxation in the Home State. According to the judge, a loss-forfeiture in the Source State by way of a restructuring or a sale would also fulfil a restriction by factual means and affect the taxation of the Home State.

Moreover, the judge was apparently of the opinion that such losses could be considered not only for corporate income tax purposes but also for trade tax purposes, although the trade tax pursues the territiorialtity principle taxing only profits derived in a domestic PE.

With respect to the question in which accounting period final losses should be deductible, the presiding judge seemed to favour the year in which the finality becomes evident (2001), instead of the year in which the losses occur (2000).

The BFH seemed to be reluctant to refer to the ECJ. According to the presiding judge, the interpretation of EU Law would most probably be clear.

On 15 June 2010, the BFH announced the operative provision (guideline) of its judgment according to which both appeals (tax authority/plaintiff) will be partly accepted. This confirms that our above described understanding is correct:

- The losses of the French PE which is closed before the time limitation of a loss carry-forward expires are *final* in the meaning of *Lidl Belgium.*
- Those losses will not only affect the German corporate tax, but also the trade tax.
- Final losses will only be deductible in the year in which the finality becomes evident (so in 2001).

The written judgments will be published within the next 3 month.

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Germany – Follow-up decision in the case Glaxo Wellcome

On 5 May 2010, the German Federal Finance Court (BFH) released its follow-up decision in the case *Glaxo Wellcome* (C-182/08) which dealt with the so called "blocked amount" of Sec. 50c ITA (for further facts see our EUDTG Newsflash 2009 - 026 of 22 September 2009 and Newsflash 2009 – 019 of 14 July 2009) the purpose of which was to avoid tax abuse of imputation credits.

In its decision of 17 September 2009, the ECJ held that the German provision is only compatible with EU law if it does not go beyond what is necessary to preserve the imputation credit only for residents and provides for a case-by-case analyses in order to assess whether the persons concerned pursue tax abuse. Moreover, the ECJ held that the application of Sec.

50c ITA should not trigger any trade tax. As the blocked amount might not only comprise an imputation credit, but also undisclosed reserves, the ECJ referred the case back to the German Court in order to establish the compliant blocked amount (mainly imputation credit). Apart from this, the ECJ made clear that a provision which does not only cover wholly artificial arrangements, but covers all cases in which a resident taxpayer acquires shares from a non-resident, would not meet the proportionality test. Although the ECJ referred the case back to the German Court, para. 100 of the ECJ decision could be interpreted that it is not within the German Court´s remit to add such a test by reading down, if the provision does not provide for it genuinely. As the German provision did not provide for such a case-by-case analyses, one could have come to the conclusion that the entire Sec. 50c ITA will not be applicable anymore.

However, the German BFH decided in an opposite and rather cryptic way and eventually referred the case back to the preceding Lower Finance Court of Munich in order to establish the proper blocked amount as well as to reveal the need to avoid tax abuse. Thus, Sec. 50c ITA remains still applicable, but is read down by adding somewhat of a proportionality test. Moreover, and in contradiction to the ECJ, the BFH is of the opinion that the trade tax would not go beyond what is necessary and therefore could still be levied on the proper blocked amount.

At the moment, we understand the BFH´s judgment as follows:

- The taxpayer (acquirer) must be given the chance to prove that the acquisition price does not (partly) comprise an imputation credit.
- If the taxpayer (acquierer) can prove that the price he paid for the acquisition from a non-resident seller is lower (or not higher) than that for the acquisition from a resident seller, no blocked amount will be assessed. Thus, Sec. 50c ITA would not be applicable entirely for corporate income tax and trade tax purposes.

However, in case the acquisition price from a non-resident is higher or comprises (partly) an imputation credit, it remains unclear whether the proper blocked amount will be limited to the (partly) reimbursed imputation credit or even extended to the undisclosed reserves revealed by the acquisition.

Now, it is with the Lower Finance Court to apply this peculiar BFH decision on the actual case. Hopefully, this decision will shed light on the BFH´s intentions.

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Germany – Case pending with Federal Fiscal Court (BFH) on fiscal unity without conclusion of a loss absorption agreement

On 17 March 2010, the Lower Fiscal Court of Rheinland-Pfalz (1-K-2406/07) rejected the application of the German fiscal unity rules (Organschaft) to a Danish loss making subsidiary. The decision has been published only recently and is now pending with the Federal Fiscal Court (I R 34/10).

In the case at hand, a German parent company established in 1987 a 100% subsidiary in Denmark and provided it with equity of 5 m DK. In the following years, the subsidiary generated losses of about 5 m DK and was finally closed in 2005. As write-downs on the participation are not deductible for tax purposes, the German parent company applied in the fiscal year 2002 for a cross-border fiscal unity with a subsequent loss deduction, although (i) the German Corporate Income Tax Act does not provide for such a fiscal unity abroad and (ii) requires (in domestic cases) a profit and loss pooling agreement between the companies.

The Court rejected the claim mainly based on three reasons:

1. No restriction but equal treatment

In the Court´s view, the situation of a parent company with a foreign subsidiary without having concluded a profit and loss pooling agreement can only be compared properly with that of a German parent with a German subsidiary also without having concluded such an agreement. As neither the latter situation nor the cross-border situation can constitute a fiscal unity, the Court concluded that there is no restriction at all. Thus, the Court rejected the alternative approach to compare a domestic situation *with* an agreement with that of a cross-border situation *without* such an agreement.

2. Absence of a loss absorption agreement

Even in case the alternative approach is applicable and a restriction is evident, the Court is of the opinion that the condition of a profit and loss pooling agreement (concluded in advance, lasting at least for 5 years) should not be waived completely, but has to be read down to the condition of a loss absorption agreement, as this would be feasible from a civil law perspective in cross-border situations. However, such a loss absorption agreement was not concluded between the parties. The fact that the equity was completely used up was not considered to be an economic burden of the parent company and cannot be compared with a loss absorption agreement.

3. No in-phase deduction of final losses

In case the reasons under (1) and (2) will be dismissed, the Court is of the view that final losses should only be deductible in the year in which they become final (here: in 2005 and not in 2002). Thus, the Court judged in accordance with the latest BFH decisions on the deductibility of final losses of foreign permanent establishments (see our Newsflash of 15 June 2010).

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Germany – Lower Fiscal Court judgement on cross border utilization of losses from rental income

On 5 May 2010, the Lower Fiscal Court of Rhineland Palatine decided on the utilization of rental income losses from immovable properties abroad.

In the case at hand, a German couple in 2004 and 2005 incurred a loss from the letting of a holiday house in France. Based on the ECJ decisions *Ritter Coulais* (C-152/03 and EUDTG Newsalert 2006 - 003) and *Marks and Spencer* (C-446/03 and EUDTG Newsalert 2005 - 016), the couple intended to deduct the loss in their German tax return against their German income arguing that the losses could not be settled against positive income in France in that period.

The Court denied the cross border loss deduction based on the ground that the taxing right for positive as well as for negative income from immovable property according to the Double Tax Treaty has been allocated to France. This allocation had been overruled in the above mentioned judgments as the loss could not be utilized in the source state anymore. As the French tax law in the case at hand provided for a loss carry forward, the loss had not been final and Germany was therefore not obliged to consider the French loss for tax purposes.

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Norway – Ministry of Finance submits written response to EFTA Surveillance Authority on Norwegian exit-tax rules

Nowray's Ministry of Finance has submitted a written response to the EFTA Surveillance Authority ("ESA") regarding Norwegian exit tax rules. The Ministry maintains their position that the rules are in compliance with EEA-regulations and that there is no need for amendment.

The letter from the Ministry of Finance was made in response to a letter of formal notice by ESA of 10 March 2010, in which the ESA concluded that the current exit-tax rules are in breach with EEA-regulations. A formal notice is the second stage in an infringement procedure. Following this notice, the State has two months to submit observations in a written response. This response was submitted by the Ministry of Finance yesterday. ESA may now issue a reasoned opinion and refer the case to the EFTA Court.

The current exit-taxation rules are applicable if a Norwegian tax resident company transfers the effective management (tax residency) to another country, either by reallocating or by a cross-border merger. The company's assets and liabilities are regarded as realised for tax purposes (all hidden reserves). The shares of the company are also regarded as realised for the shareholders of the company. To ESA, these rules constitute a non-justifiable restriction.

A discussion paper on the Norwegian tax rules on the reorganisation of businesses was on public hearing until 1 June 2010. If the proposed amendments are adopted, it will be possible to carry out cross-border mergers within the EEA on a roll-over basis. In their response to ESA, the Ministry states that the formal notice will be taken into account in the follow-up of the pulic hearing, and that ESA will be kept informed on the development of the new rules. If the

suggested cross-border merger amendments are adopted, some amendments to exit-taxation rules may be expected as well.

The Ministry offers few new arguments in response to convincing arguments from ESA. Norway has two months following the expected issuance of a reasoned opinion from ESA to amend the exit-taxation rules. If no change is made, ESA will most likely refer the case to the EFTA Court. It remains to be seen whether the proposed amendments in the discussion paper are adopted, and what effects this will have on Norwegian exit-taxation rules.

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Italy – Constitutional Court declares Sardinia's tax on stopovers of private jets and boats is unconstitutional

On 9 June 2010, the Italian Constitutional Court established the unconstitutionality of the regional tax (so-called "luxury tax"), imposed by the Italian Autonomous Region of Sardinia, on certain stopovers of private jets and boats in its territory operated by companies and individuals who, for tax purposes, are resident outside that Region.

On 17 November 2009, the ECJ had established after the referral made by the Italian Court that the measure at hand was in breach of the freedom to provide services and, at the same time, constituted prohibited State aid (C-169/08):

- The application of the "luxury tax" made the services concerned more costly for the companies and individuals who have their tax domicile outside the territory of the Region and who are established in other Member States. In this manner non-residents were discouraged from making stopovers - and therefore from providing services in Sardinia;
- The restriction, based on the different treatment existing between residents and non-residents, could not be justified by the purpose of health and environmental protection pursued by the same measure, because stopovers of private jets and boats operated by residents also polluted the environment.

The ECJ stated that the measure at hand also constitutes State aid, within the meaning of Article 87 EC, as it:

- Could distort competition considering that it gave an economic advantage to operators established in Sardinia;
- Was able to influence trade between Member States considering that it affected services potentially provided by EU undertakings;
- Was granted by means of Regional resources because, conferring the advantage only to residents in its territory, Sardinia indirectly renounced its tax revenues;
- Was selective, as the advantage was conferred only to undertakings tax resident in Sardinia, notwithstanding non-resident undertakings, who provided the same services, were in an objectively comparable situation with respect to the nature and objectives of the measure at hand.

On the basis of the ECJ's decision on the freedom to provide services, the Italian Court established that the "luxury tax" is unconstitutional, because it is in breach of article 117 of the Italian Constitution. That article gives to the Italian State and the Italian Regions the power to enact law observing the Italian Constitution, EU Law and Italy's international obligations.

For the Italian Court, consequently, it has not been necessary to further analyze the unconstitutionality of the measure at hand with reference to the State aid matter. The effect of the unconstitutional declaration made by the Italian Constitutional Court is "ex-tunc". As a consequence, taxpayers subject to the "luxury tax" could claim back the latter relevant to the years not yet time-barred.

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Romania – New rules for relief of tax losses of foreign PEs and taxation of savings income in the form of interest payments

On 28 June 2010, Government Emergency Ordinance no. 58/2010 amending and supplementing the Fiscal Code was published. Such ordinance introduced a number of changes, some of them with an EU Law dimension.

It should be recalled that under the previous tax provisions, it was possible that losses suffered by a domestic permanent establishment (PE; branch) were taken into account at the level of the Romanian head office, whereas, in a cross-border situation, any losses realised through a foreign PE of a Romanian head office were deductible only from future income derived by that PE.

From 2010, losses incurred by a foreign PE located in an EU/EFTA country of a Romanian head office, or located in a country with which Romania has concluded a double taxation convention, will be taken into account at the level of the Romanian head office.

This amendment to the law appears to be in line with the application of the national treatment test from the perspective of the origin member state and comparability with a comparable national establishment.

Income from interest on savings derived from Romania by individuals resident in other EU member states will be subject to a withholding tax of 16% (similar to the tax treatment applicable to Romanian resident individuals in relation to the same item of income). This measure appears to follow the provisions of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments which allow member states to levy other types of withholding tax in accordance with domestic law or double taxation conventions.

The new Romanian legislation came into force on 1 July 2010.

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United Kingdom – Double taxation treaty relief: judicial review challenge

In the case of Shiner v HMRC, the Court of Appeal has granted an application for judicial review of a UK provision which has the effect of retrospectively removing double taxation treaty relief from UK residents who have invested indirectly in an overseas partnership, for example, through trusts. The challenge is on the basis of contravention of the free movement of capital provisions of the TFEU.

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EU DEVELOPMENTS

EU – European Commission Communication on re-launch of Single Market postponed until after Summer

The European Commission has missed a self-imposed deadline to produce a formal reaction to former EU Commissioner Monti's suggestions for re-launching the Single Market and the role of taxation therein

On 20 October 2009, Commission President Barroso announced he had tasked Mario Monti, a former EU Commissioner for the Internal Market, Financial Services and Tax Policy from 1995 to 1999 and for Competition from 1999 to 2004, with the mission of "preparing a report containing options and recommendations for an initiative to re-launch Europe's Single Market as a key strategic objective of the new Commission".

On 10 May 2010, the Monti report was finally presented to Barroso. No spectacular recommendations on direct tax policy were to be expected – and indeed were not made in the report – since direct taxation does not fall within the remit of the EU, although the powers retained by the EU's Member States must be exercised consistently with EU Law. Monti has very pragmatically opined that full tax harmonisation is neither feasible nor really necessary to build up "non-distortive and Single Market-oriented tax systems within the EU".

Monti has issued the following key recommendations on direct taxation:

- Further work is needed to eliminate remaining tax barriers within the Single Market, modernizing e-invoicing rules, updating rules on cross-border loss relief;
- Introduction of a binding dispute settlement mechanism covering double taxation suffered by individuals and reviewing the EU's Savings Directive;
- Work towards a common definition of the corporate tax bases and move forward with the work of the Code of Conduct Group on Business Taxation;
- Agreement on the establishment, at the initiative of the Commission, of a tax policy group chaired by the Commissioner in charge of taxation and composed of personal representatives of the Member States' Finance Ministers as a forum for strategic and comprehensive discussion of tax policy issues.

The Commission's DG Markt was to prepare a Communication (policy paper) on behalf of the Commission in response to Monti's recommendations, which was scheduled to be presented to EU leaders at the European Council meeting of 17 June 2010, This deadline was not met, however. The Communication has been postponed and is now expected in October 2010. In the meantime, in a parallel move, Algirdas Semeta, the EU Tax Commissioner, is expected to organise a first meeting of the revamped high-level EU Tax Policy Group (this group was actually never formally disbanded), in September 2010 to discuss the topic of fiscal aspects of the Single Market as addressed in the Monti report. The outcome of this high-level discussion should also be reflected in the forthcoming Communication. Click here for the Monti report.

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EU – European Commission publishes annual report on taxation trends in the EU / EEA

The European Commission has issued its annual report on taxation trends in the European Union. This report contains a detailed statistical and economic analysis of the tax systems of the Member States of the EU, plus Iceland and Norway, Members of the European Economic Area (EEA). The data are presented within a unified statistical framework which makes it possible to assess the heterogeneous national tax systems on a fully comparable basis.

The standard classifications of tax revenues (by major type of tax or by level of government) presented in most international tax revenue statistics are hard to interpret in economic terms. This publication stands out for offering a breakdown of tax revenues by economic function (i.e. according to whether they are raised on consumption, labour or capital). This classification is based on disaggregated tax data and on a breakdown of the revenue from the personal income tax. Besides revenue data, the report also contains indicators of the average effective tax rate falling on consumption, labour and capital, as well as data on environmental taxation and on the top rates for the personal and corporate income tax.

Country chapters give an overview of the tax system in each of the 29 countries covered, the revenue trends and the main recent policy changes. Detailed tables allow comparison between the individual countries and European averages. Data covers the 1995-2008 period and is presented both as a percentage of GDP and as a percentage of total taxation.
To go directly to the report click here.

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Belgium – European Commission requests Belgium to modify its discriminatory tax treatment of foreign investment companies

On 3 June 2010, the European Commission sent a reasoned opinion to Belgium on discriminatory aspects of its taxation of foreign investment companies.

Under Belgian law, Belgian investment companies do not effectively pay tax on their Belgian-sourced interest and dividend income. They get a refund for any Belgian withholding taxes on their Belgian-sourced interest and dividend income. Foreign investment companies have to pay withholding taxes of 15 or 25% on their Belgian-sourced interest and dividend income and cannot claim refunds. The Commission considers that the Belgian law is discriminatory and restricts the free movement of capital and the freedom of establishment.

According to the Commission these discriminations are incompatible with articles 49, 54 and 63 of the Treaty on the Functioning of the European Union (TFEU) and with the corresponding articles 31, 34 and 40 of the Agreement on the European Economic Area (EEA).

The Commission's request is very promising news for foreign investment companies that have been subjected to withholding taxes on Belgian-sourced dividends and interest, and marks a significant step forward. Moreover, it reveals the strength of the position for those

investment companies which may have been reluctant to make withholding tax reclaims in Belgium because, for example, they were outside the scope of the UCITS directive and so felt less comfortable with the arguments for comparability and therefore the case for making claims in Belgium.

We strongly recommend that all regulated investment companies, UCITS or non-UCITS, review their past and future withholding tax position and consider the cost/benefit of making withholding tax reclaims in Belgium. Investment companies that have yet to file protective claims for the recovery of taxes should be aware that a statute of limitation applies in Belgium, thereby increasing the need for prompt action.

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Spain – European Commission requests Spain to amend its inheritance and gift tax regime

On 5 May 2010, the European Commission formally requested Spain to amend its tax provisions regarding inheritance and gift tax, Law 29/1987 of 18 December as the EC deems these provisions to be incompatible with the free movement of workers and capital under Articles 45, 63 and 65 of the Treaty for the Functioning of the European Union (TFEU).

Under the Spanish tax system, either the State or the common territory autonomous communities can levy taxes on inheritances and gifts. Which legislation is applicable, will depend on the place of residence of the testator and, in the case of real estate, on whether the real estate is located in Spain. The amount of taxation levied on a taxpayer can vary, depending on which legislation applies.

The Spanish state tax is the only applicable tax in the case of (i) limited tax liability and unlimited liability where the testator is resident abroad, or in cases of (ii) gifts of real estate located abroad, and where common territory autonomous communities do not have legislative powers or have not exercised these powers.

In all other cases, only the legislation of the common territory autonomous communities applies. All common territory autonomous communities have exercised these legislative powers, which in practice can sometimes mean that the tax burden borne by the taxpayer is lower than would have been the case under state legislation.

The Commission has now pointed out that care must be taken in order to avoid undesired discrimination. The Commission considers that applying state legislation may constitute in some particular cases an obstacle to free movement of both workers and capital.

Spain has two months to react to the Commission's Reasoned Opinion. In case no satisfactory reaction to said reasoned opinion is undertaken, the Commission may decide to refer the case to the ECJ.

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STATE AID

Finland – European Commission declare Finnish tax exemptions for REITs (Real Estate Investment Trusts) not to be state aid

On 12 May 2010, the European Commission issued a press release in which it authorises, under the EU state aid rules, the Finnish introduction of "Real Estate Investment Trusts" (REITs) that will be exempted from corporate income tax in order to encourage investments in affordable rental housing.

The objective of the measure is to encourage investment in the Finnish rental housing market, so as to increase the supply of affordable rental accommodation. To benefit from the regime, REITs must meet the following requirements:

- REITs should be publicly-listed;
- No single shareholder will own, directly or indirectly, more than 9.99%;
- REITs will only operate in the field of rental accommodation with at least 80% of their gross income coming from rents; and,
- REITs will distribute at least 90% of their annual profits to shareholders as dividends.

The Commission concludes that the previously described regime does not constitute state aid, since the exemption from corporate income tax for REITs is linked to the requirement of immediate distribution of annual profits to shareholders, at the hands of which taxation then takes place. Thus, this mechanism puts the tax treatment of an investment in a REIT at par with the taxation of direct investments by individuals in real estate.

However, the Commission considered that a provision allowing REITs to use up to 30% of their annual profits to create tax exempt re-investment reserves would constitute incompatible aid. Following the Commission's concerns, the Finnish authorities made the commitment not to put in force this provision.

It appears from this decision that a tax exemption for investment funds or trusts, is a non-selective measure (i.e. no state aid), provided that taxation at the level of the ultimate shareholders is safeguarded.

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Italy – European Court of First Instance confirms Italian tax scheme on the recognition of hidden capital gains of privatised banks constitutes state aid

On 1 July 2010, the European Court of First Instance (CFI) issued its decision in the BNP Paribas Case (T-335/08) confirming that the Italian tax scheme from 2003 on the recognition of hidden capital gains of privatised bank constitutes State aid, within the meaning of article 87(1) of the EC Treaty (now Article 107 of the Treaty on the Functioning of the EU - TFEU).

In the 1990s the banking system was privatized in Italy by contribution of the assets of the formerly state-owned banks into publicly limited companies and the subsequent sale of a part of the new companies' shares to private investors by the contributing entities (converted into non-profit bodies so-called "banking foundations"). Law no. 218 of 1990 on the privatization of the Italian State-owned banks provided for, at Article 7(2), the tax neutrality of the contribution of the assets. On 24 December 2003, the Italian parliament enacted Law no. 350 of 2003 (so-called Financial Law for 2004), which at Article 2(26) provided that capital gains resulting from these privatizations could be released by paying a substitute tax.

According to the European Commission's decision, issued on 11 March 2008, the Italian tax scheme laid down in Article 2(26):

- Granted an advantage to certain banks represented by the difference between the substitute tax effectively paid to realign the value of the property and the tax which would have been normally paid in the absence of the above mentioned provision (37.25%, i.e. 33% corporate tax and 4,25% regional business tax);
- Granted an advantage attributable to the State as it resulted in a reduction of the tax revenues normally collected by the Italian Tax Authorities;
- Was a selective measure as limited solely to the banks concerned with the reorganisations governed by Law 218/1990;distorted competition, strengthening the financial position and the competitiveness of the beneficiary banks in the EU common market of financial services.

On the basis of that analysis, the Commission concluded that the 2003 tax scheme constituted State aid incompatible with the Internal Market. As Italy failed to notify the scheme to the Commission before its implementation, the aid illegally granted has been recovered from its beneficiaries. The Commission limited the recovery to the difference between the tax actually paid and the tax the beneficiary banks would have paid in the case of application of the general tax revaluation scheme provided for by Article 2(25) of the same Financial Law for 2004.

BNP Paribas, a company involved in the recovery procedure of the illegal State aid, appealed against the Commission's decision.

The CFI has now confirmed the whole analysis made by the Commission, as well as the Italian measure being a selective State aid which Italy recovered correctly.

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