

Newsalert

EU Direct Tax Group

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JUDGMENT IN CASE C-265/04 (BOUANICH): DIFFERENT TAXATION OF CAPITAL GAINS FOR RESIDENT AND NON-RESIDENT INDIVIDUALS

Mrs. Bouanich is a French resident who held shares in a Swedish investment company. The company repurchased shares from its shareholders, which in Sweden triggers a capital gains tax of 30 %. Swedish residents are taxed on such gain after deduction of base cost and expenses. The gain of a non-resident, on the other hand, is treated as a dividend and subject to a 30 % withholding tax, without deduction of base cost and expenses. The double tax treaty between Sweden and France provides for a reduced rate of withholding tax on dividends of 15 %. This rate was applied to the gross selling price. Mrs. Bouanich appealed and asked for a reduction to zero and secondly, that the tax on the par value of the shares be repaid (the latter was granted by the tax authorities). The District Court of Sundsvall referred the case to the ECJ and asked if a) the different treatment of residents and non-residents in respect of capital gains is in accordance with the free movement of capital in the EC treaty, b) it is consistent with the same freedom to apply the double tax treaty between Sweden and France where this treaty reduces the tax rate on the capital gain and moreover, grants a deduction of the par value of the shares and c) if the treatment is allowed under the freedom of establishment of the EC treaty?

The ECJ delivered its judgment on January 19, 2006, thereby following the opinion of AG Kokott from July 14, 2005. It initially asserted that the resale of shares to an issuing company constitutes a capital movement which is covered by the Directive 88/361/EEC for the implementation of the free movement of capital and the nomenclature to that Directive. The nomenclature is still indicative for determining the notion of capital movements. The transaction in question therefore falls within the scope of Community rules relating to the free movement of capital.

In respect of the first question, the ECJ noted that residents and non-residents are subject to different rules and that the right to deduct base cost is an advantage granted only to shareholders resident in Sweden. The effect of such legislation is to make cross-border transfer of capital less attractive both by deterring non-residents from investing in Swedish companies and by constricting the opportunities for such companies to raise capital outside Sweden. The refusal to allow non-residents to deduct base cost therefore constitutes a restriction on the free movement of capital. Art. 58 of the EC treaty cannot serve as justification for the restriction: Residents and non-residents are in a comparable situation regarding base cost in case of a share repurchase and the different treatment therefore constitutes an arbitrary discrimination against non-resident shareholders. Other justification arguments were not brought forward.

As to the second question, i.e. whether it makes a difference that the provisions of the double tax treaty limit the taxation of non-residents to 15 % of the gain after deduction of par value, the ECJ firstly stated that the double tax treaty forms a part of the legal background to the proceedings and as such has to be taken into account when giving the referring Court an interpretation of Community law. The ECJ then noted that it must be ascertained whether residents are treated more favourably than non-residents after application of the treaty to decide if there is a restriction. In order to do so, it is necessary to know both the base cost as well as the par value, which is a matter for the national court. The ECJ held that the free movement of capital precludes the application of such provision of a double tax treaty as in the main proceedings, except where non-residents are not treated less favourably than resident shareholders. Whether this is the case in the specific situation has to be decided by the referring court.

In light of the answers to the first two questions, it was not necessary to answer the third question.

After the *Bouanich* judgment, it is clear that the provisions of a double tax treaty - as part of national law - have to be taken into consideration when deciding if there is a discrimination against non-residents in the Source State. Even if a double tax treaty provides for a reduced tax rate, the refusal to grant non-residents deductions from the tax base might constitute a discrimination, had resident tax payers paid less tax in a comparable situation. Whether or not this is the case has to be tested individually on a case-by-case basis.

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