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ECJ Cases

Belgium – AG opinion on non-deductibility of payments for supply of services to resident of another Member State or to foreign establishment: SIAT SA v. Belgian State (C-318/10)

According to Article 54 of the Belgian Income Tax Code of 1992 (hereafter “BITC”), certain types of business expenses (such as interest, service fees, etc) are not deductible where they are paid to a non-resident located in a country where the corresponding income is subject to a substantially more advantageous tax regime than the Belgian tax regime unless the Belgian taxpayer proves that such payments relate to genuine and proper transactions and do not exceed normal limits.

Given that Article 54 of the BITC is not applicable where such business expenses are paid out to Belgian residents (even when subject to a tax regime which can be considered as more advantageous than the common tax regime) the Belgian Supreme Court lodged a request for a preliminary ruling on 2 July 2011 on the compatibility of Article 54 of the BITC with Article 49 of the TFEU concerning the freedom of services.

In his opinion of 29 September 2011, AG Villalón compares Article 54 of the BITC to Article 49 of the BITC which can be considered as the general rule for deductibility of business expenses.

According to the AG, the difference between both rules is mainly the standard of proof that is required to be provided to obtain the deductibility (in case of Article 49 of the BITC) or to counter the non-deductibility (as provided for by Article 54 of the BITC).

Overall, the AG considers that the burden of proof provided for by Article 54 of the BITC (and as detailed in the official commentaries of the BITC) results in a restriction of the free movement of capital as mentioned in Article 49 TFEU. Although this restriction can in principle be justified in view of the fight against tax evasion or abuse, the AG considers Article 54 of the BITC, due to its general and thus non-specific nature, as disproportionate.

The AG therefore concludes that Article 54 of the BITC is in breach of the freedom to provide services as per Article 49 TFEU.

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Belgium – ECJ referral on the potential application of the Parent-Subsidiary Directive on liquidation proceeds: Punch Graphix Prepress Belgium NV v. Belgian State (C-371/11)

According to Article 671 of the Belgian Company Code, a merger by acquisition is a legal act whereby all assets and liabilities of one or more companies are transferred to an existing company as a result of a dissolution without liquidation. According to Article 210 of the Belgian Income Tax Code (BITC), however, the tax treatment of liquidated

companies also applies to companies acquired in a merger by acquisition. In this respect, Article 209 of the BITC provides that liquidation proceeds which are distributed by the dissolved company to its shareholders over and above its fiscally paid-in capital are treated as dividends to which the “Dividend-Received Deduction (DRD)” regime applies, i.e. 95 % of the “deemed dividend” will be deductible from the corporate income tax base.

Based on this deemed liquidation treatment, Belgium takes the view that the EU Parent-Subsidiary Directive does not apply as Article 4 of this Directive excludes liquidation proceeds from its scope.

Consequently, the Belgian tax authorities do not allow the carry-forward of any excess DRD. Previously the Belgian tax authorities upheld the same reasoning on excess DRD following a normal dividend distribution. However, the ECJ ruled the latter as contrary to Article 4 of the EU Parent-Subsidiary Directive (cfr. *Cobelfret NV* case C-138/07 and *KBC Bank NV and Beleggen, Risicokapitaal, Beheer NV joined cases C-439/07 and C-499/07*).

On 13 July 2011, the Court of Appeal of Gent lodged a reference for a preliminary ruling to the ECJ in order to establish whether this reasoning in case of a deemed dividend is compatible with Article 4 of the EU Parent-Subsidiary Directive following a merger by acquisition.

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Belgium – ECJ referral on compatibility of dividend withholding tax with free movement of capital: Tate & Lyle Investments (C-384/11)

In the case of Tate & Lyle Investments Ltd versus the Belgian State, the Tribunal of First Instance of Brussels lodged a prejudicial question to the ECJ regarding the compatibility with the free movement of capital of the withholding tax on dividends attributed by a Belgian subsidiary to its parent company, in case of a shareholding of less than 10%.

Where a Belgian company receives a dividend from a less than 10% interest in a Belgian subsidiary with a purchase value of more than EUR 1,2 million (now EUR 2,5 million), a withholding tax of 10% will become due. Moreover, the Belgian "Dividend Received Deduction" reduces the corporate income tax base of the Belgian parent company with respect to 95% of the dividend income. The dividend withholding tax can be credited against the corporate income tax due and any excess is eligible for a refund.

Contrary to the above, where a parent company resident in another Member State holds the same interest in a Belgian subsidiary, the withholding tax cannot be offset nor refunded in Belgium.

Clearly the net dividend received will be higher for the Belgian parent company compared to a parent company resident in another Member State. Therefore, the

Tribunal of First Instance of Brussels lodged a preliminary question to the ECJ regarding the compatibility of the Belgian regime with the free movement of capital.

Finally, as regards to the compatibility of the Belgian regime with the free movement of capital the Court seems to consider "prima facie" that there is indeed a discrimination.

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France – ECJ judgment on compatibility of French *avoir fiscal* and *précompte* with freedom of establishment and free movement of capital: Accor (C-310/09)

Following a referral from the French *Conseil d'Etat*, on 15 September 2011, the ECJ confirmed the incompatibility of the French *avoir fiscal* and *précompte* mechanisms (repealed as from 2005) with the freedom of establishment and the free movement of capital enshrined in the EC Treaty, now TFEU.

The ECJ first considered that the failure to grant the *avoir fiscal* tax credit in respect of dividends paid by non-French EU subsidiaries to their French parent companies (whilst providing such a tax credit on dividends paid by French subsidiaries in an equivalent situation), is an unjustified difference in treatment which is likely to deter French companies from investing their capital in subsidiaries established in other Member States. In the absence of the *avoir fiscal* tax credit, the French parent company was liable to pay the *précompte* (a kind of advance tax payment) in respect of any onward dividend distributions to its own shareholders.

The ECJ further held that the French State cannot object to a refund of the *précompte* on the grounds that this unjustly enriches the applicant companies, or that the applicant company could potentially have passed on the burden of *précompte* to its shareholders by reducing the amount of the net dividend paid.

According to the ECJ, these arguments must be rejected as the regimes of *avoir fiscal* and *précompte* do not, of themselves, lead to the passing on to a third party of a tax liability unduly paid by the person liable for that tax.

Finally, in order not to favour dividends received from EU subsidiaries compared to dividends received from French subsidiaries, the ECJ held that EU law does not preclude the national court from demanding, in respect of each disputed dividend, evidence of the tax rate actually applied to profits realised by the distributing subsidiaries based in other Member States, as well as evidence of the amounts of tax paid. This is the case even though such evidence is not requested in respect of distributions from French subsidiaries. The procedures regarding the provision of such evidence must however be flexible and not overly burdensome, in a way that would make a claim for repayment of the *précompte* excessively difficult. It is for the national court to determine whether these conditions of proof are met.

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Germany – ECJ judgment on withholding tax on outbound dividends: Commission v. Germany (C-284/09)

On 20 October 2011, the ECJ decided that the German dividend taxation with respect to withholding taxes for nonresident companies is not in line with the free movement of capital.

According to current German tax law, dividend payments are subject to withholding tax of 26.375% irrespective of the recipient's place of residence. However whereas resident companies who receive dividends benefit from a participation exemption regime which leads nearly to a full refund of withholding tax, foreign resident recipients who do not benefit from the Parent Subsidiary Directive could only get a partial reduction according to domestic law or an underlying Double Tax Treaty (except in rare cases where the treaty provides for 0% withholding tax). The remaining withholding tax is final and could only be credited against the income tax in the state of residence.

In its decision the ECJ held that this different treatment constitutes a restriction of the free movement of capital. The justification reasons brought forward by the German government were all dismissed: Germany could not argue that the remaining withholding tax will be credited by the home state as this would not fully neutralize the higher tax burden. The fact that resident shareholders are subject to an additional trade tax which will not be due for non-residents was also dismissed, as the discrimination on corporate income tax cannot be compensated with an advantage with respect to trade tax, if any.

The decision has an effect on portfolio shareholdings and shareholdings which do not benefit from the Parent Subsidiary Directive held by EU resident companies and companies resident in Iceland and Norway. The judgment implies that Germany is obliged to refund the withholding tax to foreign companies upon application. Foreign companies should apply for such a refund within the statute of limitation.

Due to the budgetary impact of this decision it cannot be excluded that the German government will amend the participation exemption regime by excluding portfolio shareholdings from its scope in the near future.

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Germany – ECJ referral on interpretation of EU-Switzerland Agreement on free movement of persons

On 7 July 2011, the Lower Fiscal Court of Baden-Württemberg (3 K 3752/10) referred a case to the ECJ asking for guidance on the interpretation of the Agreement on free movement of persons between the EU and Switzerland. The Agreement provides for non-discrimination regarding individuals doing business abroad.

In the case at hand, a German couple lived in Switzerland, but were doing business in Germany. They both opted for full tax liability in Germany. However, they were not allowed to opt for joint taxation, which would lead to a lower tax burden, as neither of

them resided within the EU/EEA. The couple challenged the tax assessment of 2008, arguing that the refusal of joint taxation of Swiss residents is in breach of the non-discrimination clause included in the Agreement.

Art. 16 (2) of the Agreement states that -as far as concepts of EU law are involved- these concepts have to be interpreted in the light of ECJ decisions prior to the date of its signature (21 June 1999). If the non-discrimination clause of this Agreement has an impact on tax matters, the ECJ decisions in the cases *Schumacker* (C-279/93) and *Asscher* (C-107/94) need to be considered. As a result, the couple could opt for a joint taxation.

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Portugal – ECJ decision on discriminatory dividend taxation (pension funds): Commission v. Portugal (C-493/09)

On 6 October 2011, the ECJ issued its decision on the action brought on 1 December 2009 by the European Commission v. the Portuguese Republic. The Commission sought a declaration from the ECJ that by taxing dividends received by non-resident pension funds at a higher rate than dividends received by pension funds resident in Portuguese territory, the Portuguese Republic has failed to fulfil its obligations under Article 63 TFEU and Article 40 of the EEA Agreement.

Under the provisions of the Tax Benefits Statute and the Corporate Income Tax Code, dividends paid to pension funds set up and operating in accordance with the Portuguese legislation are exempt from corporate income tax. By contrast, dividends paid to pension funds resident in the EU and EEA are subject to corporate income tax at the currently applicable final rate of 21.5% (20% rate at the date when the EC brought the referred action forward).

The ECJ, following the AG, concludes that, regarding the taxation of dividends distributed by companies established in the Portuguese territory in respect of shares held by a pension fund for more than one year, the disputed law, which in practice has the effect of dissuading non-resident pension funds from investment in local companies, constitutes a restriction on the free movement of capital that is prohibited, in principle, by Article 63 TFEU. The impossibility for non-resident pension funds to prove that they meet the requirements of Portuguese tax law is not proportionate to the difficulties pleaded by the Portuguese Republic regarding the collection of information and recovery of tax debts.

The ECJ decision is expected to lead to an amendment of domestic tax law, extending the dividends exemption to non-resident pension funds.

Regarding already filed pending refund claims: at court level, the domestic courts' future decisions are expected to be in line with the ECJ decision; and at tax authority level: rejected decisions can be appealed at the court.

Regarding new refund claims: these should be filed in order to request the refund of the excess tax paid in respect to dividends received as from 2009, and be based on the ECJ decision.

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Spain – ECJ referral on discriminatory inheritance and gift tax rules

On 27 October 2011, the European Commission decided to refer Spain to the ECJ for discriminatory rules on inheritance and gift tax that require non-residents to pay higher taxes than residents. The Commission had already formally requested Spain on 5 May 2010 (IP/10/513) and additionally on 17 February 2011 to take action to ensure compliance with the EU rules with regard to inheritance and gift tax provisions. However, no amendments have been made to the Spanish legislation on the matter.

Inheritance and gift tax in Spain are regulated at both state level and at the level of autonomous communities. The autonomous communities' legislation grants residents a number of tax benefits that, in practice, allow them to pay much lower taxes than non-residents.

The Commission considers this discriminatory tax treatment to constitute an obstacle to the free movement of people and capital, fundamental principles of the EU's Single Market, and is in breach of Articles 45 and 63 TFEU respectively.

Regarding the arguments brought forward by the Commission, it can reasonably be expected that the ECJ will decide that the rules at issue are indeed in breach of EU law. However, such a decision by the ECJ would not directly improve the tax situation of EU tax residents who paid inheritance taxes at a higher rate than Spanish tax residents. Should EU tax residents want to challenge the excess inheritance tax paid in Spain, they would have to personally claim for a refund of such excess before the competent Spanish Tax Office now. If not, these protective claims could be time barred at the moment the ECJ judgment is made available.

If the outcome of a personal refund claim process is successful, the claimant will be entitled to obtain the refund of the unlawful tax plus late payment interest.

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National Developments

Belgium – Applicable statute of limitation for claims introduced by non-resident companies for the recovery of Belgian withholding tax

An interesting issue was raised as regards the applicable statute of limitation for introducing a refund claim, in the case of Tate & Lyle Investments Ltd versus the Belgian State (**C-384/11**). The ECJ ruled that for a claim introduced by a non-resident company for the recovery of the Belgian withholding tax, the statutory time limitation of six months should be applied. According to this statute of limitation, a claim must be filed within six months following (1) the date of the assessment notice or (2) the date of the "Collection of the taxes" (other than by assessment notice).

In respect of non-residents not being subject to Belgian income tax, the Tribunal of First Instance of Brussels considered that the six months period starts as from the collection date of the withholding tax, being the moment of the payment of the withholding tax in case of the tax administration not responding.

In addition, the Court refuses the 5-years statute of limitation for the ex officio tax relief in case of an overpayment of taxes due to new facts or records, based on the decision of the Commission versus Italy of 19 November 2009 (C-540/07).

Future for "Fokus bank claims" in Belgium?

Although at first sight this decision seems not to be in favour of non-resident investors who have filed "Fokus bank claims" in Belgium based on extended statutes of limitation (i.e. outside the 6 months statute of limitations), some positive elements can also be found in the judgement.

As regards the statutes of limitation, the 5-years statute of limitation based on the Consolidated Law of 17 July 1991 on State Bookkeeping seems not to have been brought forward by the claimant. In practice, many of the "Fokus bank claims" have been introduced based on this statute of limitation. Also, the Court seems to consider that a decision of the ECJ on the current reference for a preliminary ruling could be seen as a "new fact" making it possible to introduce an ex officio tax relief as described above. Moreover, there are also arguments to defend that the six months period as set forth by the Court in itself contains a discrimination between non-residents not being subject to Belgian income tax (not filing a tax return) and and Belgian residents and non-residents being subject to Belgian income tax, and therefore filing a tax return in Belgium.

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Germany – Interpretation of "commercially maintained business establishment" in CFC legislation

The Federal Fiscal Court (BFH) decided recently (I R 61/09) that a business establishment of a subsidiary located in the Irish "Dublin Docks" has to be considered as *commercially maintained* even if the business is carried out by a third party via

management agreement. Such a subsidiary would fulfil the activity requirement and will not trigger the German CFC-rules.

In 1995, a German insurer carried out business in Dublin through a wholly owned subsidiary, X Ltd. that was allowed to perform the reinsurance business and fulfilled the requirements for the reduced corporation tax rate of 10 % in 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. The 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. Out of the insurance contracts which XYZ Ltd. acted as an agent for, X Ltd. received premium payments and had to settle claims. The profit from this business was invested in securities.

The BFH had to decide if the requirement of a *commercially maintained business establishment* was fulfilled by X Ltd. If the answer is positive, the insertion of the Irish subsidiary does not trigger CFC taxation for the German parent company. Such an establishment is to be affirmed if the company has adequate 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 some professional literature consider employment of own personnel necessary, whereas others consider management agreements with services companies sufficient.

The BFH decided that the service company conducted the business in the name and on the account of X Ltd., which bears all economic risks and chances, and attributed XYZ-Ltd.'s activities and its business establishment to X Ltd. Thus, the management agreement with XYZ-Ltd. is not harmful to a *commercially maintained business establishment* of X Ltd.

Although the BFH did not base its decision on EU law, it stated that under the given circumstances a management agreement could not lead to the conclusion that the insertion of X Ltd. is a "wholly artificial arrangement" in the sense of the *Cadbury Schweppes* decision (C-196/04). The negation of X Ltd.'s activity would be in breach of the freedom of establishment.

After the decision in the *Cadbury Schweppes* case in 2006, Germany amended its CFC-rules by providing for an escape if there is a *genuine economic activity*. The legislative material to the escape clause states that own personnel are necessary to fulfil this requirement and that outsourcing is not sufficient. As the BFH has now decided that outsourcing is not harmful for the criterion *commercially maintained business establishment*, it seems questionable if something different can apply in respect of a *genuine economic activity*.

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Italy – Supreme Court on deadline for the submission of refund claims in case of ECJ decisions

On 26 October 2011, the Italian Supreme Court issued judgment no. 22282 regarding the deadline for the submission of refund claims in case of new interpretation of the Italian provisions given by the ECJ's decisions.

In the case at hand, an Italian taxpayer submitted a claim requesting the refund of indirect taxes on lubricating oils suffered in the years 1996-2003. The refund claim was submitted based on the ECJ judgment relevant to case C-437/01 (issued on 25 September 2003) in which the ECJ stated that the Italian tax provisions on lubricating oils were in breach of Directive 92/12/EEC. On the basis of the Italian specific provisions on the statutory limitations on these indirect taxes, part of the taxes claimed-back by the Italian taxpayer were, at the time of the submission of the claim, definitively time barred (in particular the indirect taxes suffered in the period 1996/2001).

In its judgment, the Italian Supreme Court established that in case of an unexpected change in a consolidated interpretation of an Italian law, made via an ECJ decision, the timeline for the submission of refunds claims of the unlawful taxes starts from the date of the ECJ decision. On this matter, for the submission of the claims, it is not clear if taxpayers have 2 years from the ECJ decision (generic statutory limitation) or the different specific timeframes provided for by the rules related to the tax actually claimed-back.

According to the principle established by the Italian Supreme Court, it seems that, whenever the ECJ overrules an Italian tax provision, taxpayers can submit refund claims for the taxes in breach of EU law, paid in the past, independently from the Italian provisions about the statutory limitations.

Such a principle could have an impact on the Fokus Bank claims. In fact, considering the ECJ decision in the case C-540/07 (*Commission v. Italy* issued on 19 November 2009), in which the ECJ declared the Italian withholding tax on outbound dividends in breach of the EU law, foreign companies could be entitled to submit refund claims for past years independently from the Italian statutory limitations.

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Netherlands – Dutch Tax Package 2012: legislative proposals

On 15 September 2011, the Dutch Government published the 2012 Tax Package. Both the House of Representatives, which is able to amend the legislative proposals, and the Senate have to grant their approval. The legislative process will be completed by December 2011 and most of the legislative proposals are set to become effective as of 1 January 2012. A number of legislative proposals which potentially trigger EU law issues are discussed below.

Restriction of interest deduction on acquisition debt

The proposed 2012 Tax Package introduces a restriction of interest deductions on acquisition debt if a Dutch target company is acquired by a (newly established) Dutch holding company, with which it is subsequently included in a fiscal unity. Based on the proposed measure, the acquisition company can no longer offset its interest expenses against the profits of the target company. Under the proposed measure, such expenses can only be offset against the profits of the acquisition company itself. According to the NOB (Dutch Association of Tax Advisors), an acquisition by a foreign acquiring company is, therefore, *de facto* treated disadvantageously as such a company (through its Dutch holding company) generally does not have any 'own' Dutch profits.

PE losses no longer deductible

Under the current regime, losses incurred by a foreign PE can be offset against profits of the Dutch head office. Profits earned by the foreign PE are in principle exempt from Dutch corporate income tax (first, PE losses which have been deducted in previous years have to be recaptured). The 2012 Tax package proposes a radical change, namely the introduction of an object exemption. As a result, losses incurred by a foreign PE can no longer be offset against profits of the Dutch head office. To comply with the *Marks & Spencer* case, an exception is made for final losses, which can be offset against Dutch profits. Foreign currency exchange losses and gains will continue to affect the Dutch taxable base.

Expat arrangement (30%-ruling) restricted

If expats meet certain conditions, they are eligible for a 30% tax allowance. An amendment of the expat arrangement has been proposed. The proposal amends this arrangement, amongst others, by excluding from this arrangement employees who live within a radius of 150 kilometers from the Dutch border. The measure was introduced to avoid distortions in the border area. The NOB has raised the question whether or not this aspect of the proposal is in breach of EU law (as it discriminates between residents of different Member States).

Amendment of substantial interest taxation

In the reasoned opinion of the European Commission (IP/10/1252, 30 September 2010), the Netherlands was requested to change the legislation that exempts domestic companies from tax on their income from substantial interests, but which taxes companies established elsewhere in the EU and EEA on income from substantial interests not forming part of their business assets. These EU/EEA companies will now only be subject to tax under the proposed legislation if the substantial interest is held by the foreign shareholder with the main intention or one of the main intentions to avoid Dutch personal income tax or dividend withholding tax. It is doubtful whether the proposed anti-abuse measure is in line with EU law.

Foreign charities and church organizations

Furthermore, in response to the reasoned opinion of the European Commission (IP/10/1252, 30 September 2010), the Dutch government proposed legislation to exempt foreign charities and church organizations from tax if they are comparable with the Dutch legal forms in question (*stichting, vereniging*). Under current Dutch legislation,

domestic charities and church organizations which do not carry on a business, are exempt from taxation on income from real estate in The Netherlands. However, under current legislation, non-resident foreign charities and church organizations are subject to tax on any income from property they may have in the Netherlands, irrespective of whether or not they carry on a business.

Refund of dividend withholding tax

The scope of the refund scheme in the Dutch Dividend Withholding Tax Act will be extended to third countries with which adequate information exchange agreements have been concluded. This extension applies only to portfolio investments. The proposed extension of the refund scheme will especially apply to dividend distributions to exempt pension funds which are established in qualifying third countries.

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Poland – Successful cases of recovering withholding tax paid by EU and EEA funds

From 1 January 2011, new legislation applies to the Polish law that aimed at ending discriminatory tax treatment of foreign EU and EEA funds. These new rules were further amended during the past year because of changes in the Polish law regulating functioning of funds in Poland. As a consequence, under certain conditions, EU and EEA based investment funds can benefit from a corporate income tax exemption effective from 1 January 2011.

PwC has developed arguments based on EU law. Although before 1 January 2011 there was no clear exemption in the Polish corporate income tax law for foreign funds, we successfully assisted foreign funds to file claims for refunding the withholding tax collected by the remitters in 2004 – 2010. The refunds were given at the administrative level and no court proceedings were required. Additionally, the cash was paid to the foreign funds within one year from the date when the application was submitted. PwC Poland has last year helped clients to recover over PLN 10 million (ca. EUR 2,3 million) in withholding tax, for four foreign funds in total. Many proceedings are still pending.

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Poland – Changes in the Polish corporate income tax law with regard to investment funds

The Polish corporate income tax (CIT) law was recently amended with regard to investment funds. The changes will be effective as of 4 December 2011. The following new conditions will be introduced into Article 6 of the CIT law outlining conditions which must be met by EU and EEA funds to benefit from the CIT exemption:

- The funds have to carry out their activity under the permission of the competent financial supervision authorities in the country of their establishment, or conducting of their business requires notification to the competent authorities in the country of establishment, provided that:

- they conduct their activity in the form of a collective closed-end investment institution, and
- in accordance with their incorporation deeds, their units are neither offered through a public offering nor released to trading on a regulated market, nor are released to the alternative trading scheme, and can be acquired by individuals only when they make a single purchase of the units at a value of not less than EUR 40,000.
- The funds activities have to be subject to direct supervision of the competent authorities of the financial market supervision of the state in which they are established;
- The funds have to be managed by entities that carry out their activities under the permission of the competent authorities for the financial market supervision of the state in which these entities are established.

PwC Poland is currently examining which particular funds may meet these conditions and thus benefit from the CIT exemption. It is difficult to foresee the impact of the amendment on the tax position of foreign funds in Poland. This is due also to the fact that the Polish tax authorities refuse to confirm in advance the eligibility of particular foreign funds for CIT exemption in Poland.

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Portugal – Proposed 2012 State Budget Law

The proposed 2012 State Budget Law proposal foresees the following measures:

Controlled Foreign Companies - CFC

Portuguese CFC rules are not applicable if the subsidiary is resident in another EU country or in a European Economic Area (EEA) member State, which is bound to administrative cooperation on tax matters in a manner that is equivalent to the one existing in the EU; for that, there should be valid economic reasons underlying the incorporation and running of the subsidiary, which must carry out agricultural, commercial, industrial or service activities. It is also foreseen that CFC rules will be applicable also if the CFC (if not excluded under the rule above) is indirectly held by a Portuguese entity (i.e. through a legal representative, fiduciary or intermediary).

Tax representative

Further the procedure brought by the European Commission against Portugal (Case C-267/09), the mandatory appointment of a tax representative for non-resident entities without a permanent establishment in Portugal that obtain income derived from Portugal will no longer be applicable to entities resident in a EU or EEA member State (bound to administrative cooperation on tax matters); this applies to both non-resident corporations and individuals.

Foreign Pension Funds

Further to the procedure brought by the Commission against Portugal (Case C-493/09), the exemption from corporate income tax applicable to pension funds incorporated

under the Portuguese law will be extended to income obtained by pension funds established in another EU country or in an EEA Member State (which is bound to administrative cooperation on tax matters);

Foreign pension funds should cumulatively fulfil the following requirements:

- Exclusively assure the payment of retirement pensions granted from elderly, handicapped, surviving, pre-retired, health and post-employment benefits, and death benefits, when complementary and ancillary to the previously mentioned;
- Are managed by pension funds professional institutions to which Directive 2003/41/EC of 3 June 2003 applies;
- Are the effective beneficiary of the income;
- In case of dividend distributions, the related shareholding should have been held for a consecutive 1-year period;
- Furthermore, proof should be made available to the entity responsible for withholding the tax, prior to the date in which income is made available, that all the necessary requirements are verified. These requirements should be certified by a statement to be issued, confirmed and authenticated by the Member State regulatory authorities.

The proposed 2012 State Budget Law proposal is under discussion in the parliament.

-- Leendert Verschoor, Jorge Figueiredo and Anabela Mendes, PwC Portugal;
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Portugal – Cyprus and 1929 Luxembourg holdings scrapped from list of tax havens

Cyprus and Luxembourg (the latter with regard to 1929 Luxembourg Holdings) were removed from the Portuguese list of tax havens. The arguments for removal were the following: (i) Cyprus and Luxembourg are both EU Member States: (ii) Luxembourg has revoked its legislation on 1929 holdings (therefore the list was outdated); and (iii) the mutual assistance between the tax authorities in EU Member States is now significantly regulated, and which will furthermore be reinforced by the transposition of the Council Directive 2011/16/EU of 15 February 2011, on administrative cooperation in the field of taxation.

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Spain – Leading tax firms establish Tax and Competitiveness Foundation

A number of leading tax firms in Spain, including PwC Tax & Legal Services, Baker & McKenzie, Cuatrecasas, Gonçalves Pereira, Deloitte Abogados, Ernst & Young, Abogados, J&A Garrigues, S.L., KPMG Abogados and Uría Menendez, have decided to establish the 'Tax and Competitiveness Foundation'.

The Foundation's mission statement is: "Considering the notable complexity of the current model and the experience gained from the high volume of litigation resulting from its practical application, the FUNDACIÓN IMPUESTOS Y COMPETITIVIDAD (Tax

and Competitiveness Foundation) believes that both Spanish and European Union ("EU") tax regulations – and their practical application– must be reviewed, innovated and improved, to enhance the competitiveness of the Spanish and the other EU economies, based on research into, and study and dissemination of, international taxation, in active collaboration with the public economic, financial and tax authorities and supervisory bodies of both Spain and the EU, encouraging Spain's public and private sectors to become more open to foreign relations." See for more: <http://www.fundacionic.com/en/>

-- Antonio Puentes, PwC Spain; antonio.puentes@es.pwc.com

United Kingdom – Thin Cap Group Litigation: no re-referral to ECJ

On 28 October 2011, the Supreme Court refused to re-refer the issues raised by claimants in the Thin Cap GLO to the ECJ. A panel of Lords Phillips and Hope had reconsidered the case after the panel chaired by Lord Walker in the summer had refused leave to appeal the case to the Supreme Court. Accordingly, the 2:1 decision of the Court of Appeal against the taxpayers is now final.

Following the ECJ decision in favour of Georgi Elchinov on 5 October 2010 in case C-173/09, a taxpayer who considered that the Court of Appeal's majority decision was 'inconsistent with EU law' could consider maintaining a claim for commercially justifiable debt/ interest even though the quantum of debt was arguably greater than arm's length, and appealing a closure notice disallowing the deduction to the First-tier Tribunal, asking for a re-referral of the issue to the ECJ to direct that the Court of Appeal decision not be followed. Claimants in the Thin Cap GLO may consider taking similar action. The only other possible remedy left is a Kobler action against the UK for misapplication of EU law and Commission infringement proceedings against the UK. Neither are currently likely.

-- Peter Cussons and Chloe Paterson, United Kingdom; peter.cussons@uk.pwc.com

United Kingdom – Court of Appeal finds for the taxpayer in Marks & Spencer Plc case on cross-border group relief

In June 2010 the Upper Tribunal upheld lower court decisions in favour of Marks & Spencer Plc regarding cross-border group relief claims/surrenders, and as to the quantum of those claims, although some claims were held to be out of time notwithstanding the EU law principle of effectiveness. HMRC appealed the Upper Tribunal decision, and the appeal was heard by the Court of Appeal in June 2011. HMRC was challenging several aspects:

The time at which a taxpayer has to demonstrate that the losses are "final" (i.e. there is no possibility of use in the territory of the surrendering company) - HMRC argued that this should be immediately after the end of the accounting period in which the loss was incurred, rather than the time at which the group relief claim is made.

The basis of the final loss test - HMRC submitted that it should be a pure legal test, without any reference to the particular circumstances of the loss-making company.

HMRC also argued that if €1 of loss was used, that blocked the whole of the loss from being available for surrender.

The "parallel claims" point - the Upper Tribunal/ First-tier Tribunal and Court of Appeal in February 2007 held that M&S could make additional claims without withdrawing their original claims, as the original claims were ineffective (no final losses as the subsidiaries were still trading).

In a unanimous judgment, the Court of Appeal has rejected HMRC's appeal, but permission has been granted for both parties to appeal all points the Supreme Court. This means that M&S will also be able to appeal the earlier decision that some claims were made out of time.

-- Peter Cussons and Chloe Paterson, United Kingdom; peter.cussons@uk.pwc.com

United Kingdom – Trustees of the BT pension scheme v HMRC - Pension fund claims for tax credits on FIDs / EU dividends

Trustees of a pension fund claimed payment of tax credits in respect of foreign income dividends (FIDs) received ("FIDs claims") and foreign dividends received ("*Manninen* claims"). The First Tier Tribunal (FTT) found the relevant statutory provisions which prevented claims for tax credits to be in breach of the free movement of capital a) in relation to FIDs claims, in so far as the FIDs were funded by income arising in EU member states; and b) in relation to *Manninen* claims, in so far as the dividends were paid by companies established in EU Member States. A decision regarding FIDs / foreign dividends funded by income arising in third countries was stayed pending a High Court decision in the CFC and Dividend Group Litigation. However, the majority of the claims were made outside of Taxes Acts statutory time limits. The FTT did not consider that there was any principle or authority to support an extension of the statutory time limits, and consequently, the majority of the claims were dismissed. It is therefore unlikely that other funds will be able to benefit from the decision unless they have already made claims for tax credits under the Taxes Acts or made High Court claims for restitution or damages as part of the FIDs Group Litigation.

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United Kingdom – Mindpearl AG v HMRC - Cross border "transfer of trade" treatment denied

Mindpearl AG (a Swiss resident company owned 100% by SwissAir) purchased a UK trade from a fellow German company, owned 59% by SwissAir. Mindpearl argued that losses should be transferred across under the UK "transfer of trade" provisions, following the principle of freedom of establishment (Article 43 EC Treaty, now Article 49 TFEU). The First Tier Tribunal found clearly for HMRC on the basis that Article 43 could not apply as one party to the transaction was not in an EU Member State.

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EU Developments

EU – European Commission presents Proposal for a Directive on Financial Transaction Tax (FTT)

On 28 September 2011, EU Commission President Barroso announced the EC's proposal for an EU-wide Council Directive on a common system of financial transaction tax (FTT) and amending Directive 2008/7/EC in his State of the (European) Union speech to the European Parliament. On 30 October 2011, Germany's finance minister said that if the UK blocks the FTT in the full EU, the 17 Euro-zone Member States should consider introducing FTT in the Eurozone as a first step . Click here to see [PwC's Newsflashes on the FTT proposal and the implications for the Global FS industry](#).

NEXT STEPS:

- The draft Directive has also been sent to the 27 national Parliaments for the subsidiarity principle test (i.e. whether they believe the EU Commission has overstepped its competence and that the proposal should not be introduced at EU-level). A one-third minority of national Parliaments could thus delay the law-making process for 3 months and force the EU Commission to "review" its proposal (so-called "yellow-card system"). The 8-week deadline elapsed on 30 November 2011.
- On 5 December 2011, technical expert discussions will start on the FTT proposals in the EU Council Working Party on Tax Questions. If this EU Council Working Group can reach agreement on the technical and planning aspects, the proposal is moved up to COREPER (II), i.e. the EU Council's political voting assembly composed of the EU-27 permanent representatives. If political agreement cannot be reached here, the proposal moves up to ECOFIN.
- The debate on FTT must be seen in the context of the current highly charged political debate in Europe on strengthening of economic convergence within the EU/ Euro-zone, improving fiscal discipline and deepening economic union, including even the possibility of limited EU Treaty changes. EU leaders will meet again on 9 December 2011 to discuss these matters. The Euro Plus Pact Member States (23 of the EU-27) will discuss progress on national implementation of the Pact's commitments, including a report of their Finance Ministers on progress made on coordination of tax policy issues. There's an urgent need for clarity among all parties on FTT, and in the current Euro crisis, it cannot be ruled out entirely that certain EU leaders will try to speed up the introduction of FTT in a subset of EU Member States.
- Denmark will take over the rotating 6-monthly EU Presidency from Poland on 1 January 2012. FTT is earmarked as a top priority initiative. The Danish presidency will therefore be instrumental in taking FTT further. An important date may be the final ECOFIN meeting under the Danish presidency on 19 June 2012. PwC is closely monitoring the developments on FTT.

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EU – EU leaders Euro Summit Statement on pragmatic coordination of tax policies in the Euro-zone

Following the Euro Summit of 26-27 October 2011 in Brussels, EU leaders issued a Statement in which they announced that they had agreed to: "pragmatic coordination of tax policies in the euro area", and that work on the Commission proposals for a CCCTB and for a FTT was ongoing. For the full version of the 27 October 2011 Euro Summit Statement click [here](#).

In the context of the ongoing Euro-crisis, a highly charged political debate has evolved in Europe around the need for strengthening economic convergence within the EU/ Euro-zone, improving fiscal discipline and deepening economic union, including even the possibility of limited EU Treaty changes. EU leaders will meet again on 9 December 2011 to discuss these matters. The Euro Plus Pact Member States (23 of the EU-27 Member States) will discuss progress on national implementation of the Pact's commitments, including a report of their Finance Ministers on progress made on coordination of tax policy issues. There's an urgent need for clarity among all parties on the way forward, and in the current Euro-crisis, it cannot be ruled out entirely that certain EU leaders will try to speed up the process of increased tax coordination / further tax harmonisation in a subset of EU Member States.

-- Bob van der Made, PwC Netherlands; bob.van.der.made@nl.pwc.com

EU – Incoming Danish EU Presidency tax priorities

Denmark will take over the rotating 6-monthly EU Presidency from Poland on 1 January 2012 until 1 July 2012) and is expected to deal with / be instrumental for a great number of important Commission tax proposals and initiatives until the end of June 2012, including:

- Proposed CCCTB Directive
- Double taxation and double non-taxation/aggressive tax planning (likely to be preceded by a public consultation in Q1 2012)
- Recast of Interest and Royalties Directive
- FTT Directive / FS Taxation
- Good governance in relation to third countries
- Arbitration in cross-border tax dispute resolution
- Inheritance tax communication
- Review of the EU's VAT System
- Review of the EU's Energy Taxation Directive

An important date may be the June ECOFIN meeting and the subsequent European Council Summit under the Danish Presidency in June 2012.

EU leaders will meet again on 9 December 2011 to discuss strengthening of economic convergence within the EU/Euro-zone, improving fiscal discipline and deepening economic union, and possible EU Treaty changes. There's an urgent need for clarity

among all stakeholders on the way forward, including on tax coordination and fiscal consolidation, and in the current Euro crisis, it cannot be ruled out entirely that some EU leaders will try to speed up this process in a subset of EU Member States.

-- Bob van der Made, PwC Netherlands; bob.van.der.made@nl.pwc.com

EU – EU Tax Commissioner Šemeta speeches on EU tax policy and tax competition in Europe

On Tuesday 25 October 2011, EU Tax Commissioner Algirdas Šemeta entered into the European Parliament's plenary debate on Taxation in Strasbourg where he talked about: "[Reaching a level playing field for taxation across Europe](#)". He also replied to MEP's questions about the bilateral UK and German deals with Switzerland on Taxation of Savings" and a possible EU Commission reaction on these deals, and about "aggressive tax planning". A day later, Šemeta gave a speech in Porto at an economic forum on: "[Competitive tax policy and tax competition in the EU](#)".

-- Bob van der Made, PwC Netherlands; bob.van.der.made@nl.pwc.com

EU – EC report on 'Tax reforms in EU Member States: Tax policy challenges for economic growth and fiscal sustainability'

The European Commission has published a [report](#) entitled: 'Tax reforms in EU Member States: Tax policy challenges for economic growth and fiscal sustainability', which takes a look at recent trends in tax revenues and tax reforms implemented in Member States.

-- Bob van der Made, PwC Netherlands; bob.van.der.made@nl.pwc.com

EU – European Commission adopts FISCALIS proposal

The European Commission has adopted "FISCUS", the new financing programme covering EU customs and taxation for the period 2014-20, as foreseen within the EU's Multi-Annual Financial Framework proposal adopted by the European Commission in June (see [IP/11/799](#)). This programme is the successor of the current FISCALIS 2013 and CUSTOMS 2013 programmes. The idea behind it is to support cooperation between the customs and tax authorities and other parties through networking and knowledge-sharing, and by funding state of the art IT infrastructure and systems. In the current economic situation, according to the Commission, this programme will deliver real benefits to public finances by improving the ability of Member States and the EU to collect revenue and fight fraud. The Commission believes this programme will also help Member States to cut costs, particularly by sharing IT development and facilitate trade, improve the functioning of the Internal Market and "promote pro-growth tax reforms."

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Germany – European Commission launches infringement procedure on "transfer of hidden reserves"

On 29 September 2011, the European Commission reported its formal request to Germany to amend the provision on the "transfer of hidden reserves" in case of reinvestments abroad.

According to Sec. 6b German Income Tax Act (ITA) the taxation of capital gains from selling German real estate or inland vessels can be deferred by deducting them from the acquisition cost of newly purchased assets, mainly real estate and inland vessels as well. The deduction reduces the base for future write-downs and, thus, the taxation of capital gains is deferred.

In order to obtain a so called "transfer of hidden reserves", several requirements have to be met. One of them is that the newly acquired asset belongs to a German permanent establishment (PE). Assets which belong to a foreign PE, irrespective of whether Germany has a right to tax the profits and capital gains of this PE or not, are not entitled to such a transfer.

The Commission is of the view that this territorial limitation is in breach of the freedom of establishment (Art. 43 TFEU and Art. 31 EEA) as it hinders taxpayers establishing or expanding their economic activity abroad.

The request takes the form of a reasoned opinion (second step of an infringement procedure) so that Germany needs to react within two months. Otherwise the Commission can take action before the ECJ.

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CCCTB

EU – Update on the CCCTB

The European Commission's Proposal on CCCTB is still being discussed in the Council Working Party on Tax Matters under the Polish presidency and is currently at the "article-by-article reading" stage. This may take several months. Little progress is expected under the remainder of the Polish EU presidency. More progress ("a window of opportunity") is expected next year under the next Danish EU presidency. The subsequent EU presidencies are held by Cyprus (1 July - 1 December 2012) followed by Ireland.

The EU's Committee of the Regions (CoR) presented its proposed amendments to the Commission's CCCTB proposal. CoR Rapporteur, Mr Gusty Graas (LU/ALDE), Member of the municipal council of Bettembourg, Luxemburg, presented his draft consultative CoR opinion on the CCCTB on 3 October 2011. He supports the idea of a CCCTB but calls for a number of modifications to the proposal including "an opening clause for local and regional corporate taxes to include them in the consolidated corporate tax base." Furthermore, the optional nature of the system as it is proposed by the Commission

would oblige businesses to constantly compare the common tax base with existing national systems in order to select the most advantageous system. The rapporteur therefore suggests that businesses make one definite choice after a transition period. CoR Rapporteur Graas has said that: "These essential modifications could ensure a real reduction in administrative burdens for businesses and administrative simplifications for local and regional authorities."

The European Parliament's report on CCCTB may be discussed during the European Parliament's plenary sitting on 28 March 2012, and an orientation debate on CCCTB will follow in June 2012 in the Council.

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State aid

Italy – ECJ decision on tax advantages granted to cooperative companies

On 8 September 2011, the ECJ issued its judgment in the joined cases (C-78/08, C-79/08 and [C-80/08](#)) *Paint Graphos Scarl*.

In these joined cases the Italian Supreme Court asked to the ECJ if the incentives granted to cooperative companies for mutual benefit free of private speculation through tax exemption can be ruled to be State Aid within the meaning of Art. 87 EC (now Art. 107 TFEU) and if the answer is in the affirmative, if the incentives can be considered as proportionate.

The ECJ holds that the tax benefits granted to cooperative companies are financed through State resources and are liable to affect trade between Member States distorting competition within the meaning of Article 87 EC. The ECJ, however, states that the condition of selectivity needs to be determined by the referring Court.

The criteria for the referring Court to conclude if the measure is selective or not are provided by the ECJ. Special mutual characteristics of cooperative companies, in principle, cannot be regarded as being in the same factual and legal situation to that of commercial companies so the condition of selectivity is not met. However, cooperatives companies which do not have the special mutual characteristics and therefore act in the economic interest of their members and their relations with members are purely commercial instead of personal and individual or without members actively involved in the running of the business or not entitled to equitable distribution of the results of the economic performances, can be regarded as being in the same legal and factual situation. In such a case the measure could be considered selective.

The ECJ holds finally that in the latter case the referring Court has to ascertain whether the tax benefits are justified by the nature or the general system and in particular that it is to the Member State concerned to introduce and apply appropriate control to ensure

that the tax benefits designed for cooperative companies are consistent with the logic and general scheme of the system and to prevent economic entities from choosing that particular legal form for the sole purpose of taking advantage of the tax benefits provided to that kind of undertaking.

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EU – Recast of EU State Aid Guidelines for Maritime Transport

The existing Community Guidelines on State aid to Maritime Transport date from 17 January 2004. The European Commission is legally required to review these Guidelines within 7 years after their publication.

The European Commission has confirmed that it will launch a public consultation in December 2011 or in January 2012. The Commission will have 18 months to adopt a final decision based on the public consultation as to whether and where the existing Community Guidelines on State aid to Maritime Transport require any amendments or fine-tuning. The European Commission keeps the EU Parliament informed (not a legal obligation). Through the public consultation, the European Commission expects to find out which national measures EU Member States have implemented since 2004, what their effect has been on the industry and in particular whether there has been a distortive effect on competition i.e. whether they are compatible with the EU's State aid rules.

It still remains to be seen whether amendments to the Guidelines will be necessary, and also whether these are likely to be only marginal or whether they will be substantial and would warrant an impact assessment by the European Commission.

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About PwC's EU Direct Tax Group (EUDTG)

The EU Direct Tax Group (EUDTG) is PwC's pan-European network composed of dedicated EU Law experts and client servicing teams, which are in place in every country of Europe. U.S. clients are serviced in close cooperation with the PwC European country desks in the U.S. Since 2005, the EUDTG has engaged in raising clients' awareness and understanding of EU Law and the related risks and opportunities for them, and how to maximise their benefits and use their EU Law rights. The EUDTG has for instance assisted numerous clients in filing and obtaining substantial refunds of tax unlawfully exacted in various EU or EEA territories. Through its Technical Committee, which analyses and formulates PwC's view on ECJ direct tax case law, the EUDTG has been playing a leading role in actively developing new original and cutting-edge EU Law arguments and solutions that help our clients in the best way possible.

EUDTG experts are closely working together with PwC Financial Services and Real Estate colleagues combining EU Law technical skills with specific industry knowledge. Other important, more 'horizontal' client-facing EUDTG expert Working Groups have been formed around EU State aid and the CCCTB. The EUDTG is also closely monitoring EU direct tax policy and political developments in Brussels and has regular contacts with key EU and OECD policy-makers through its EUDTG EU Public Affairs capability in Brussels and the "EBIT" business initiative facilitated by the EUDTG. The EUDTG is coordinated centrally from its Secretariat in the Netherlands and operates a daily international EU tax news service for our clients. The EUDTG is embedded in PwC's International Tax Services network.

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