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## **ECJ CASES**

### **Austria – ECJ referral on tax treatment of donations to science and research institutions: Commission v. Austria case**

According to the Austrian Income Tax Act, donations to certain public Austrian institutions such as universities, art colleges or the academy of science, and to non-profit organisations performing research and educational activities mainly for the benefit of the Austrian science or economy may be deducted as operating expenses.

The European Commission is of the opinion that these restrictions are not in line with the principle of free movement of capital (Article 56 EC and Article 40 EEA Agreement) since the donations to comparable institutions abroad are not deductible even though these institutions pursue the same goals.

Due to the fact that the Austrian Government did not provide a satisfactory reaction to the Commission's earlier request to end the discriminatory tax treatment of donations in the field of science, research and adult education (see EU DTG Tax News from May 2009), the Commission in October 2009 decided to refer this issue to the ECJ.

The Commission's case reference number is: 2007/2079.

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### **Belgium – AG opinion on Belgian provision concerning abnormal and gratuitous benefits: Société de Gestion Industrielle case (C-311/08)**

On 10 September 2009, AG Kokott opined that the freedom of establishment does not preclude a provision such as Article 26 of the Belgian income tax code ("BITC") according to which a so-called abnormal or gratuitous benefit (AGB) granted by a Belgian resident company to a non-resident related company should always be added back to the taxable base of the Belgian company. An AGB granted to a Belgian related company would usually not be added back to the taxable base of the Belgian grantor as the AGB is already included in the taxable base of the Belgian beneficiary.

Firstly, the AG is of the opinion that Article 26 BITC constitutes a restriction of the freedom of establishment as the difference in treatment between national and cross border situations could impede or discourage the creation of establishments in other Member States.

Secondly, the AG examines whether this restriction can be justified by the fight against artificial constructions set up for reasons of tax avoidance or by the need to safeguard a balanced allocation of taxing power between Member States:

- Since Article 26 BITC is based on article 9 of the OECD Model Convention and article 4 of the Arbitration Convention which provide for similar profit corrections when agreements between related parties are not at arm's length, the AG considers Article 26 BITC appropriate for combatting artificial constructions;

- Article 26 BITC also safeguards the balanced allocation of taxing power between Member States by preventing that related parties grant AGB to each other and therefore shift profits between Member States.

Thirdly, the AG considers that Article 26 BITC does not go beyond what is necessary to reach its goals, for the following reasons:

- The application of Article 26 BITC only leads to the taxation of the abnormal part of the AGB (proportion);
- Article 26 BITC allows taxpayers suspected to have created an artificial construction to demonstrate the economic reasons for which the transaction took place (right of reply);
- The adverse effects generated by the profit corrections are neutralised by the fact that the beneficiary of the AGB could request its Member State of residence to take into account the Belgian correction in accordance with the Arbitration Convention (correlative adjustments).

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#### **Estonia – ECJ referral on Estonian taxation of non-residents' pensions: Commission v. Estonia case**

On 29 October 2009, the European Commission announced that it has referred Estonia to the ECJ over its discriminatory taxation of non-residents' pensions.

The decision concerns non-resident pensioners with a modest global income which does not exceed the tax exemption allowances applicable to pensioners in Estonia (EEK 63 000 or EUR 4026). If such taxpayers receive almost all their income in Estonia, they can benefit from the Estonian personal allowances and do not have to pay tax on their income. However, non-resident taxpayers who earn less than 75% of their global taxable income in Estonia cannot benefit from the personal deductions available to residents.

On 17 August 2009, Estonia proposed draft amendments to the income tax law where such discrimination should be abolished by allowing persons who earn less than 75% of their taxable income in Estonia to benefit from the personal deductions provided that they are able to prove that they cannot benefit from deductions in any other state.

As the draft changes have not been submitted to the Parliament yet, it is not clear whether the changes will be adopted and whether they will enter into force as of 1 January 2010 as proposed in the draft.

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#### **Germany – ECJ judgment on German provision to prevent tax abuse of imputation credits and wholly artificial arrangements: Glaxo Wellcome case ([C-182/08](#))**

On 17 September 2009, the ECJ decided on the compatibility with EC Treaty freedoms of a German tax provision established under the former imputation system in order to avoid that a

non-resident economically benefits from the imputation credit in case of a disposal of shares to a resident shareholder.

According to this legislation, losses arising from a write-down of participations after a profit distribution were not tax deductible in so far as the tax payer had acquired the participation from a non-resident for a price exceeding the nominal value of the share.

In the case at hand, the German resident company Glaxo Verwaltungs-GmbH was disallowed the deduction after a reorganisation, solely based on the ground that it had previously acquired the relevant participation from a UK resident company and not from a German resident company.

In its reasoning, the ECJ broadly follows the AG's opinion (See [EUDTG Tax Newsr 005 - 2009](#), p. 6):

- The provision forms an obstacle to the free movement of capital. Since Germany is not obliged to grant an imputation credit to non-resident taxpayers, the restriction can be justified by the need to maintain a balanced allocation of taxing rights. The ECJ leaves it, however, for the national Court to determine whether the legislation at issue is limited to what is necessary in order to attain those objectives. As one of the criteria named by the ECJ for complying with the principle of proportionality, the measure must enable the national Court to carry out a case-by-case examination in order to assess the abusive or fraudulent conduct of the persons concerned.
- In contrast to its previous judgements in the KBC case ([C-439/07](#)), the ECJ in the case at hand measures the national legislation only against the free movement of capital. According to the ECJ's reasoning, in order to determine whether a regulation falls within the scope of the free movement of capital or the freedom of establishment, the purpose of the regulation has to be taken into consideration. The purpose of the legislation at issue is to prevent non-resident shareholders from obtaining an undue tax advantage irrespective of the size of the holding acquired. Therefore the free movement of capital aspect of that legislation prevails over that of the freedom of establishment.

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### **Germany – ECJ judgment on German tax treatment of immovable property situated in another Member State: Busley and Cibrian case ([C-35/08](#))**

On 15 October 2009, the ECJ ruled that Art. 56 EC precludes tax provisions which allow the deduction of losses from letting or leasing of immovable property and the application of the declining balance method of depreciation only if the property is situated in the resident state of the taxpayer.

Siblings Ms Busley and Mr Cibrian Fernandez inherited a house in Spain as joint heirs from their parents in 1996 which they, as they continued to live in Germany, started to let from 2001 onwards. In their tax returns for 1997 to 2003 filed in Germany as their country of residence,

Busley and Cibrian requested the application of the decreasing-balance method of depreciation as well as the offset of losses generated by the letting of the house in Spain. The German tax authority, however, rejected the application as German income tax law grants the decreasing-balance method of depreciation only under the condition that the real estate is situated within Germany. Also, the offset of losses arising from letting of real estate was at the time limited to profits generated in the same Member State where the property is located. Where losses generated in another Member State could not be taken into account in the same fiscal year, they could only be offset against profits - if any - from that Member State and of the same nature (e.g., letting or leasing) in a subsequent period.

Upon appeal, the ECJ stated that Art. 56 EC does not only apply to situations where tax provisions discourage investments in other Member State but also where a person is discouraged from the retention of property in another Member State. Answering the referring court's question on the relevance of the fact that the property was inherited, the ECJ also established with reference to the Annex I of Directive 88/361/EEC that an inheritance consisting in the transfer of assets, including immovable property, from the deceased to one or more persons falls within the scope of the freedom of capital movement.

The Court argued that the tax position of a natural person resident in one Member State who has immovable property in another Member State is less favourable than if the immovable property were located in the same Member State. The provisions at hand thus constitute a restriction of the movement of capital as residents with foreign property would suffer though not permanent but cash-flow disadvantages. While residents with domestic property could offset losses immediately, residents with property in another Member State could only offset losses with later profits from that Member State. Likewise, a person with domestic property could initially apply a higher depreciation rate than a person who holds immovable property abroad and may only apply the straight-line depreciation method.

The ECJ rejected a justification based on the principle of territoriality since that principle would simply not preclude taking foreign losses into account. Germany had further held that a restriction could be justified as the preferential depreciation method serves the public interest for satisfying demand for housing in Germany. For that, the ECJ argued, the provision was drafted too broadly as all housing projects were covered and not only areas where demand was high. The ECJ thus found that the provision was not appropriate for attaining the stated objective and a restriction of Art. 56 EC.

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**Germany – ECJ judgment on the applicability of the Parent-Subsidiary Directive to a French "société par actions simplifié": Gaz de France case ([C-247/08](#))**

On 1 October 2009, the ECJ decided that it is not in breach of the freedom of establishment (Article 43 EC) and the freedom of capital movement (Article 56 EC) to exclude a non-listed company from application of the Parent-Subsidiary Directive.

In 1999, a German subsidiary (GmbH) distributed dividends to its French resident parent company, which had the legal form of a "société par actions simplifié" (SAS). Under German

tax law, dividend payments are subject to withholding tax, unless the Parent-Subsidiary Directive (or a double tax treaty) is applicable. In 1999, the Parent-Subsidiary Directive was not applicable in such cases, because a company in the legal form of a SAS was not entitled in years prior to 2005. Since 2005, SAS are entitled, too. The Lower Finance Court asked (1) whether the Parent-Subsidiary Directive in years prior to 2005 could be interpreted in such a way that SAS are entitled although not explicitly mentioned or (2) if the Parent-Subsidiary Directive is in breach of the freedom of establishment or the free movement of capital as it favours only specific legal forms of French companies but not the SAS. Please note, the Lower Finance Court did not ask whether the German implementation of the Parent-Subsidiary Directive and the levy of German withholding tax itself is in breach of EC Law.

Regarding the first question, the ECJ followed entirely the opinion of the AG and held that the Parent-Subsidiary Directive should not only be interpreted by its wording but also by its scope and scheme. The Court acknowledged that the Parent-Subsidiary Directive aims at excluding partnerships from its scope. However, as the drafters of the Parent-Subsidiary Directive used for France the legislative technique of listing specific entitled legal forms, this could not be subject to interpretation or analogy.

Concerning the second question, the ECJ concluded that the restrictive applicability of the Parent-Subsidiary Directive only for listed companies does infringe neither the freedom of establishment nor the free movement of capital. However, the ECJ pointed out that, although the Parent-Subsidiary Directive entitles only specific legal form of entities, the Member States are not allowed to treat dividend payments to non-listed companies less favourably than dividend payments to comparable domestic companies. In this regard, the ECJ referred expressly to its former decisions in the cases *ACT Class IV* ([C-374/07](#)), *Amurta* ([C-379/05](#)) and *Aberdeen* ([C-303/07](#)).

So, although the ECJ answered both referred questions in the negative way, this does not lead automatically to an unfavourable taxation of dividend payments to French companies in the legal form of a SAS. On the contrary, the German Finance Court has now to decide which German corporation a SAS can be compared with and how dividend payments to a SAS should be taxed in order to be in line with the EC Treaty freedoms.

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**Germany – ECJ judgment on German measures designed to encourage the participation in private pension plans to relieve the national social security system: Riester Rente case ([C-269/07](#))**

On 10 September 2009, the ECJ decided that the provisions of the so-called Riester Rente are in breach of the free movement of workers. The measures were designed to encourage the participation in private pension plans and thus relieve the national social security system.

As a beneficiary of this Riester Rente scheme, a resident worker who is in the public social security scheme either receives additional benefits to his retirement contributions from the government or is allowed to deduct a higher percentage of his insurance expenses for tax purposes. Foreign workers, who do not meet the strict requirements to be taxed as residents

according to Sec. 1 (3) GITA (i.a. 90% of income derived is subject to German income tax), are excluded from this benefit.

In the ECJ's view, such a measure does not qualify as a tax benefit but as a social benefit which, in accordance with earlier ECJ judgments, can also be applied to non-resident taxpayers in order to facilitate the mobility of migrant workers within the Community. If less than 90% of the income is subject to tax in Germany, the requirement of being fully liable to German tax constitutes a restriction of the free movement of workers since the migrant worker cannot opt to be treated as resident in Germany. According to the ECJ, such a restriction arises if the 90% income requirement cannot be met because the taxing right for the migrant worker's income is allocated to the state of residence according to the respective double tax treaty.

Secondly, in order to make use of the subsidised capital for the acquisition or construction of an owner-occupied dwelling, the property has to be allocated in Germany. As non-residents are more likely to be interested in purchasing a dwelling outside Germany than residents, the ECJ held that the respective provision constitutes an unjustifiable indirect discrimination.

Thirdly, the ECJ argues that even though resident and migrant workers both have to reimburse the whole private pension bonus in case they cease to be fully liable to tax in Germany, this regulation still discriminates against migrant workers, as the latter are generally more likely to work and establish themselves in another Member State than German workers. Since this rule might also discourage German workers from exercising a professional activity outside Germany, it also constitutes a breach of the freedom of workers.

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### **Germany – ECJ referral on German provision on add back of interest payments**

Recently, the Federal Finance Court (BFH) asked for a preliminary ruling (C-397/09) on the compatibility of the add back of interest payments to the trade tax base with the Interest and Royalties Directive ([2003/49/EC](#)).

In 2003, a Dutch B.V. (parent) made a long term loan at an interest rate of 5% to a German resident GmbH (G). At the moment the interest was due (2004), the holding lasted only one year. According to a former German trade tax provision, one half of the interest has to be added back when determining the trade tax base. Thus, interest payments made by G were only deductible up to 50%. If the interest was paid between domestic resident companies, the treatment was alike.

The BFH referred two questions to the ECJ concerning the interpretation of the Interest and Royalties Directive:

(1) Does the add back comply with Art. 1 Para. 1 of the Directive?

The question is whether the Interest and Royalties Directive prohibits the (partly) non-deductibility of interest payments on the level of the payer or if it only prohibits a taxation on the

level of the beneficial owner. The BFH considered the different translations of the Directive in the various languages (income/payment) as well as the scope of the Directive to avoid double taxation which could be interpreted in both ways, juridically and economically. The BFH also noticed that any kind of levying taxes either by withholding or by assessment is prohibited by the Directive. As the add-back of interest is done by way of assessment, this might trigger an infringement. Moreover, the BFH pointed out that the effectiveness of the Directive could easily be undermined, if the tax exemption only relates to the beneficial owner.

(2) In the case the add back does not comply with the Directive: could a Member State refer directly to Art. 1 Para. 10 of the Interest and Royalties Directive and reject the application of the Directive for trade tax purposes due to fact that the holding has not been maintained for an uninterrupted period of at least two years at payment date?

At first, the BFH pointed out that the translation of Para. 10 in various languages differs when using the term "maintain" either in the present tense or in the past tense which might indicate that the Interest and Royalties Directive is also applicable in cases where the holding period requirement was not fulfilled at payment date but afterwards. Secondly, the BFH wants to know to what extent the taxpayer (and not the Member State as it is phrased in the referral) can refer directly to the Directive, if Germany has failed to implement the Directive properly. Germany implemented the Directive through the Income Tax Act for interest (and royalties) received without such a holding requirement. However, as this implementation in the Income Tax Act has no direct impact on the Trade Tax Act concerning the deductibility of interest paid, it is doubtful whether this implementation constitutes the taxpayer's minimum rights granted by the Directive, meaning that he must not fulfil the two years' holding period for trade tax purposes as well.

It should be noted that the outcome of this referral might also have an impact on the amended provision actually in force. We would like to point out that the BFH did not address the claimant's question regarding the compliance with the freedom of establishment. Nevertheless, this might be an issue when a cross-border situation is compared to a purely domestic situation which qualifies as a fiscal unity (Organschaft) where an add back would be waived. However, an Organschaft can only be set up between resident companies.

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### **Netherlands – AG opinion on Dutch elective taxpayer status regime**

On 27 October 2009, AG Ruiz-Jarabo Colomer opined in the case of *Gielen* (C-440/08), who was represented by PricewaterhouseCoopers, that the Dutch regime for elective taxpayer status under Art 2.5 of the Dutch Individual Income Taxation Act 2001 (hereafter: "IITA") is in breach of the freedom of establishment (Article 43 EC)..

Pursuant to Art 2.5 IITA, which was introduced by the Netherlands in response to the ECJ's *Schumacker* judgment (C-279/93), a non-resident taxpayer can for Dutch tax purposes choose to be taxed as a resident taxpayer. The elective taxpayer status regime is intended to ensure compliance of the Dutch income tax act with EC Law.

Gielen, a German resident who qualifies as a non-resident taxpayer for Dutch tax purposes, was denied a deduction for Dutch income tax purposes pursuant to a discriminatory rule of Dutch national law. Had the taxpayer elected to be taxed as a Dutch resident taxpayer in accordance with Art 2.5 IITA, the deduction would have been available, according to the Dutch tax authorities (Gielen argued, however, that the deduction would not have been available or at most only a part thereof).

This raises the question whether the *prima facie* restriction caused by the measure of Dutch national law (i.e. the denial of the deduction) can be neutralised by the fact that the taxpayer could have opted to be taxed as a Dutch resident taxpayer (in which case he would have had access to the deduction).

The AG resolutely rejects this position, arguing that at a fundamental level the mere fact that a taxpayer can choose between a legitimate and an illegitimate option cannot suffice to rectify a discriminatory treatment under national law.

Furthermore, the administrative costs associated with Art 2.5 IITA (e.g. the need to submit a tax return in two Member States) mean that, even if the taxpayer had opted for elective taxpayer status, he would not have been in the same position as a Dutch resident taxpayer. For this reason too, the *prima facie* restriction cannot *in casu* be justified by Art 2.5 IITA.

The AG further concludes that the inclusion of Art 2.5 IITA does not in itself render the Dutch income taxation act in line with the requirements of the *Schumacker* judgement. This maximalist approach suggested by the Netherlands would, in the AG's view, have the perverse effect that any measure in breach of EC Law might be justified by the possibility of elective taxpayer status. The AG considers this outcome undesirable. In his closing remarks, he observes that the *Gielen* case only concerns whether Art 2.5 IITA can serve as a justification of a *prima facie* restriction. The elective taxpayer status regime itself, which the AG regards as having positive elements, is not under discussion.

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### **Portugal – ECJ referral on Portuguese exit tax provisions for companies: Commission v. Portugal case**

According to articles 76-A and 76-B of the Portuguese Corporate Income Tax (CIT) Code, in case of a transfer of the seat and place of effective management of a Portuguese company to another Member State, or in case a PE of a non-resident entity ceases its activities in Portugal or transfers its assets located in Portugal to another Member State, the taxable base of that financial year will include any unrealised capital gains in respect of the company's assets, whereas unrealised capital gains from purely domestic transactions are not included in the taxable base. An exemption applies for assets that remain in Portugal and that can be allocated to a PE of the company.

Moreover, article 76-C of the CIT code foresees that the shareholders of the company that transfers its seat and place of effective management from Portugal to another country are

subject to tax on the difference between the company's net assets (value at the time of the transfer at market prices) and the acquisition cost of their participation.

In this context, companies that leave Portugal or transfer their assets abroad are subject to an immediate taxation, compared to companies which remain in Portugal or transfer their assets domestically. The European Commission considers that this difference of treatment dissuades companies from exercising their right of freedom of establishment and, as a result, constitutes a restriction of Article 43 EC and Article 31 EEA.

The Commission sent a Reasoned Opinion to Portugal in November 2008 regarding this issue. Since Portugal did not reply satisfactorily nor has amended its discriminatory legislation, the Commission has now referred Portugal to the ECJ. The Commission's opinion is based on the ECJ judgment of 11 March 2004 in Case C-9/02, *De Lasteyrie du Saillant*, and the Commission's Communication on exit taxation (COM (2006) 825) of 19 December 2006). The Commission's case reference number is: 2007/2365.

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### **Spain – ECJ referral on Spanish exit tax provisions for companies: Commission v. Spain case**

On 8 October 2009, the European Commission decided to refer Spain to the ECJ in relation to their tax provisions on exit tax for companies. According to the Spanish Corporate Tax Law, in those cases when a company changes its tax residence to another Member State or third country, or when a PE ceases its activities in Spain or transfers its Spanish located assets abroad, the unrealised capital gains must be included in the taxable base of that taxable period. However, the unrealised capital gains from domestic transfers are not included in the taxable base.

Following the case law set laid down by *De Lasteyrie du Saillant* (case C-9/02) and the Commission's Communication on exit taxes (COM (2006) 825 of 19 December 2006), the Commission requested Spain to change its legislation by means of a Reasoned Opinion in November 2008. In December 2008, the ECOFIN Council adopted a Council Resolution (political commitment not legally binding) that focuses on the desirability of avoiding double taxation when individuals or businesses transfer economic activities (including business assets) from one Member State to another without dealing with the compatibility of exit taxes with EC Law.

According to the Commission, the immediate taxation of companies on the sole ground that they transfer their seat and place of effective management or their assets abroad, constitutes a restriction on the freedom of establishment (resp. Article 43 EC and Article 31 EEA).

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**Spain – ECJ judgment on Spanish tax treatment of capital gains on immovable property held by non-residents: Commission v. Spain case ([C-562/07](#))**

On 6 October 2009, the ECJ handed down its decision in Case C-562/07 ruling that the disadvantageous treatment, up to 31 December 2006, of capital gains realised in Spain by non-residents compared to capital gains realised by residents, is contrary to Article 56 EC.

Under Spanish legislation, capital gains of non-resident individuals are taxed at a flat rate of 35%, whereas residents are subject to progressive taxation when the fixed assets remain within the possession of the taxpayer for less than one year, and to a flat rate of 15% when the assets are realised after one year of possession. Thus, non-resident individuals are always subject to a higher tax burden if they sell their property after one year of possession, and are so in most cases, if the property is sold within the year after acquisition.

In several cases, the ECJ already clearly established that it is contrary to the free movement of persons (Article 39 EC) and the free movement of capital (Article 56 EC) to tax residents and non-residents differently, if there is no objective difference between the situation of the two to justify the difference in treatment.

In the present case, up to 31 December 2006, the Spanish legislation provided for a difference in treatment of resident taxpayers and non-resident taxpayers on the tax rate applying to capital gains realised on the disposal of assets, either fixed assets or other kinds of assets, owned in Spain. The ECJ states that such a differential treatment cannot be justified. That system was repealed as from 1 January 2007 with the entry into force of Law No 35/2006.

According to this decision, taxpayers that have suffered this non-residents tax when they sold a property in Spain before 31 December 2006 should consider claiming a refund from the Spanish Tax Authorities, provided that the request is made within the applicable statutory time limits. Another opportunity may be still available since the Spanish High Court of Justice has lodged a preliminary ruling in March 2008. The outcome of this ruling will determine whether it is possible to hold a State responsible for any damages deriving from a failure to comply with EC Law.

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**United Kingdom – ECJ judgment on Stamp Duty Reserve Tax charge on issue of shares into clearance service: HSBC Holdings and Vidacos Nominees case ([C-569/07](#))**

On 1 October 2009, the ECJ found in *HSBC Holdings plc & Vidacos Nominees Ltd v HMRC* (C-569/07) that the 1.5% Stamp Duty Reserve Tax charge levied by the UK on the issue of new shares into a clearance service is contrary to the EU Capital Duty Directive (69/335/EEC). The UK authorities subsequently announced that they will not levy the charge on the issue of shares into an EU clearance service with effect from the date of the judgment.

Although the judgment deals only with the issue of shares into a clearance service, the same analysis is also considered likely to apply to the issue of shares into an authorised depository (e.g. US ADRs) and similar arguments may also apply in relation to the transfer of existing

shares to a clearance service or a depository bank. Businesses that have previously paid Stamp Duty Reserve Tax or Stamp Duty in relation to an issue of new shares or the transfer of existing shares into a clearance service or authorised repository should act now to reclaim the Stamp Duty Reserve Tax / Stamp Duty.

See also EUDTG [Newsalert 2009 – nr 019](#).

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### **United Kingdom – ECJ referral on improper implementation of the Marks & Spencer decision regarding cross-border loss relief: Commission v. UK case**

The European Commission has referred the UK to the ECJ for improper implementation of the ECJ decision in the *Marks & Spencer* case concerning cross-border loss relief. Following the ECJ's decision in M&S in December 2005, the UK introduced rules, effective from 1 April 2006, which allow relief in the UK for certain group EEA losses. However the Commission considers that the conditions for the relief mean that in practice it is almost impossible for taxpayers to benefit from it. Groups with UK tax capacity should therefore revisit their ability to make cross-border loss relief claims for periods from 1 April 2006 onwards.

See also EUDTG [Newsalert 2009 – nr 022](#).

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## ***NATIONAL DEVELOPMENTS***

### **Denmark – Danish National Tax Assessment Council considers Danish exit tax rules for companies in line with EC Law**

On 25 August 2009, the Danish National Tax Assessment Council stated that the Danish exit tax rules for companies are not violating EC Law. (reference: 09-084353, SKM2009.542).

According to the Danish Merger Tax Act, a merger between two Danish companies can benefit from a roll over relief if certain conditions are met.

Section 15 of the Danish Merger Tax Act states that a roll over relief can apply to a merger between a Danish and a foreign company with the foreign company as the continuing company provided that both companies take a form listed in the annex to the Merger Directive 90/434/EEC, and the Danish contributing company is not a transparent entity. However, the roll over relief only applies to assets and liabilities that can be allocated to the continuing company's permanent establishment in Denmark after the merger. Other assets and liabilities will be taxed according to section 5 of the Danish Corporation Tax Act.

The facts in the case were the following: The German resident company A KGaA recently acquired the Danish resident company B ApS for an amount significantly exceeding the equity in B ApS. As after the acquisition, the activity of B ApS primarily is carried out in Germany, A

KGaA intends to merge B ApS into A KGaA. As a result of the merger, there would be no PE left in Denmark. B ApS asked the Danish National Tax Assessment Council whether the Danish rules on exit taxation would apply if B ApS merged tax exempt cross border with A KGaA.

The main argument of B ApS was:

“As the sole reason for the taxation of B ApS is that A KGaA is resident in Germany, this constitutes a discrimination against A KGaA because of its nationality. This discrimination is a hindrance to the free establishment, cf. Article 48 of the EC Treaty, as the taxation according to section 5 of the Danish Corporation Tax Act would be a real hindrance for carrying out the merger and there seems to be no valid reason for such discrimination.

As EC Law overrides Danish internal legislation, our conclusion is that section 5 of the Danish Corporation Tax Act cannot be applied in B ApS’ merger with A KGaA as there is no legal basis for taxation of B ApS in connection with the merger.

The main argument of the Danish National Tax Board was:

“As the Oy AA judgement just recognised that the rule which ensures the tax base in a member state is not contrary to article 43 and that the objective of section 15, 4 of the Danish Merger Tax Act is exactly to ensure the tax base, the Danish tax authorities find that the provision of section 15, 4 of the Danish Merger Tax Act is not contrary to Community law.”

On that basis the Danish tax authorities upheld the Danish rules on exit taxation.

B ApS has appealed the decision to the National Tax Tribunal in Denmark.

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### **Estonia – Estonian Ministry of Finance proposes to amend legislation to end discrimination against foreign charities**

The Estonian Ministry of Finance has made public draft amendments to the income tax law which provide that the various forms of tax reliefs for donations made to the domestic charities will also be extended to foreign charities. However, in the same draft it says that the beneficial treatment of donations that were earlier applicable also to certain bodies established by Estonian governmental institutions will be abolished (instead of extending them to the similar institutions established by foreign governmental institutions).

The proposed changes are based on the European Commission infringement procedure announced on 27 November 2008, requesting Estonia to end its discriminatory treatment of foreign charities and certain bodies established by governmental institutions. Currently, Estonia offers various forms of tax relief for donations by resident individuals and companies. However, this favourable tax treatment is only granted if the charity is established in Estonia and is included in a special list. The beneficial treatment of donations is also extended to certain bodies established by Estonian governmental institutions and to religious organisations registered in Estonia. No relief is granted in respect of donations to similar foreign bodies and organisations.

As the draft changes have not been submitted to the Parliament yet, it is not clear whether the changes will be adopted and whether they will enter into force as of 1 January 2010 as proposed in the draft.

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### **Estonia – Estonian Ministry of Finance proposes to introduce new interpretation of exit tax provisions on PEs**

The Estonian Ministry of Finance has made public draft amendments to the income tax law which clarify the determination of taxable profits and thus taxable „deemed profit distributions“ by permanent establishments (PEs) (due to the characteristics of Estonian corporate tax system the tax liability of PEs has been deferred to the moment of “deemed profit distributions“). Although not directly provided in the changes to the text of the law, it is noteworthy that the explanatory letter to the draft provides that in calculation of profits attributable to PEs, no unrealised profits will be taken into account. This means that a cross-border outbound transfer of assets is deemed to take place at the acquisition cost and not at the fair market value of the assets in order to avoid any exit taxation in respect of unrealised profits. Although Estonia could merely defer its taxing rights and claim them at later stage when profits have been realised abroad, it has been indicated that claiming taxes abroad would be too complicated and therefore Estonia would not use this right.

According to the explanatory letter to the draft, the changes are made due to the infringement procedure of the European Commission against Estonia whereby Estonia’s attention has been drawn to the potential exit taxation issue in Estonian income tax law. Estonian resident companies may freely transfer their assets from one domestic branch to another branch in Estonia or abroad whereas non-residents become subject to tax when assets are transferred out of PEs located in Estonia (i.e. assets are deemed to be realised and tax liability created upon cross-border transfer).

As the draft changes have not been submitted to the Parliament yet, it is not clear whether the changes will be adopted and whether they will enter into force as of 1 January 2010 as proposed in the draft. As this is also merely a suggestion for a change in interpretation, it is unclear how such interpretation will be enforced in practice.

A report of the Estonian Ministry of Foreign Affairs on recent infringement procedures further provides that this infringement procedure on PEs earlier on also involved the discrimination against PEs compared to resident legal entities. This issue was dropped due to the changes in the law from 1 January 2009. Until 31 December 2008 there was a problem that certain payments made out of undistributed profits, such as for example liquidation proceeds, were not subject to corporate tax at the level of resident legal entities, while any payments out of undistributed profits of PEs, including payments on termination of PEs, were always subject to corporate tax.

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## **France – Update on EU pension fund claims in respect of French withholding tax**

Numerous claims alleging that the taxation of French source dividends paid to EU pension funds are currently pending before the French tax authorities. French “pension funds” (“caisses de retraite et de prévoyance”), being considered for tax purposes as non-profit entities, are exempt from corporation tax in respect of French-source dividends they receive, unlike foreign pension funds.

In its decision of 13 February 2009, the French Supreme Administrative Court ruled that withholding taxes levied on dividends from French shares held by EU pension funds which are similar to French “pension funds” were incompatible with the principle of free movement of capital (EC Treaty).

In September 2009, the French tax authorities sent a questionnaire to foreign pension funds who have claimed dividend withholding tax refunds in France for previous years. The questionnaire aims to establish the comparability with French “Caisses de retraite et de prévoyance”, i.e. to consider them as non-profit bodies according to the French tax doctrine.

The questionnaire is very detailed, notably with items which should be crucial to establish the comparability: link with the legislation on social protection or retirement, management, business operated, contributions, remuneration of directors etc. The questionnaire is based on the current status of French law on non-profit bodies, derived from extensive case law and evolving administrative doctrine: an entity is considered non-profit making if its management is not driven by profit-making objectives and the services that it provides are not offered in competition with those offered to the same public by commercial businesses that perform the same activities; if, however, the relevant entity nevertheless competes with commercial businesses, it is still entitled to be considered a non-profit body if its activities are carried out under conditions that differ from those under which commercial businesses operate; for the purpose of assessing this last condition, the tax authorities recommend applying the so-called “4-P” rule, which takes into account the “Product” offered to the target “Public” at the applicable “Price” and the “Promotion” carried out. Foreign claimants have 90 days to complete the questionnaire (in the French language) and return it to the French tax authorities.

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## **Germany – Lower Finance Court dismisses offset of foreign losses generated during individual's tax residency abroad**

In the case at hand, the claimant, a German national, had been living in Austria for several years before moving back to Germany at the end of 2003. From March 2003 until January 2004 she held a position as consultant and shareholder with a consultancy in Austria from which she generated losses as a tax resident. After her return to Germany, she sought to offset these losses against profits from professional services provided in Germany. As the tax office denied the offset, she filed a complaint with the Lower Finance Court of Lower Saxony arguing that the unequal treatment of domestic losses and losses from an EU Member State is not in line with EC Law. She thus claimed the offset of the Austrian losses with German profits, in

particular arguing that she had ceased to generate income from Austria and would hence be unlikely to achieve an offset with future Austrian profits.

The Lower Finance Court decided against the claimant predominantly with a view to the principle of territoriality. The alleged discrimination of domestic and foreign losses would in fact be the - inevitable - result of the claimant's relocation from Austria to Germany and the ensuing change of tax residency. The fact that the claimant in the assessment period 2003 had been tax resident in Austria and in the following assessment period tax resident in Germany would as such not amount to a relevant discrimination. The Court held that given the current state of EC Law and the taxation rights of individual Member States the discrimination at hand must be accepted by the taxpayer. Also, citing the *Weigel* case ([C-387/01](#)) which concerns excise tax on used vehicles, EC Law does not guarantee tax neutrality when moving to another Member State as long as the relocating taxpayer would not be treated differently as compared with taxpayers already resident there.

The Court further upheld that it reflects established ECJ jurisprudence, in particular *Lidl Belgium* ([C-414/06](#)), *KR Wannsee* ([C-157/07](#)) and *Marks & Spencer* ([C-446/03](#)) decisions, that losses may principally only be offset in their country of origin if in that country a loss carry-forward is possible. As losses may be carried forward in Austria, as the claimant has stated, in the eyes of the Court the non-recognition in Germany does not violate EC Law.

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### **Italy – New Italian tax regime on proceeds paid out by EU/EEA non-UCITS funds**

On 25 September 2009, the Italian Government adopted the Decree Law Nr. 135 of 2009 which introduced, amongst others, a new tax regime applicable to the proceeds paid out to Italian tax resident individuals by certain EU/EEA foreign funds which do not qualify under the UCITS Directive 85/611 (hereinafter “non-UCITS funds”).

The new regime was introduced as a consequence of the infringement procedure opened in 2008 by the European Commission against Italy. The Commission considered that there was a different tax treatment of proceeds paid out to Italian individuals by EU/EEA non-UCITS funds compared to proceeds distributed to the same investors by Italian non-UCITS funds. Before the amendments introduced by the Decree Law Nr. 135 of 2009, proceeds distributed by foreign EU/EEA non-UCITS funds to Italian tax resident individuals needed to be included in their whole taxable income and taxed at a tax rate ranging from 23% to 43%, whilst proceeds distributed by Italian non-UCITS funds were subject to a 12.5% substitute tax at the date of payment. The Commission pointed out that such difference in treatment may prevent Italian individuals from investing in quotas of foreign non-UCITS funds and, therefore, may constitute a restriction of the free movement of capital protected by Article 56 EC and Article 40 EEA.

The Decree Law Nr. 135 of 2009 amended the tax regime by applying a 12.5% withholding tax, which is levied on a cash basis to proceeds distributed by foreign non-UCITS funds. The new regime is applicable if the foreign non-UCITS funds are:

- established in an EU Member State or an EEA State included in the white list provided for by section 168-bis of the Italian Tax Code (i.e. states or territories granting the exchange of information with Italy; the list still needs to be adopted by Ministerial Decree);
- subject to the supervision of the competent authorities of State where they are established.

The 12.5% withholding tax is also applied on the gains realised upon the disposal/redemption of quotas of such non-UCITS funds, i.e. on the difference between the value of the quotas at the date of redemption/disposal and the value at the date of acquisition/subscription. The new tax regime will become applicable on proceeds paid from 1 January 2009 onwards. It should be noted that the Decree Law needs to be converted into Law by the Italian Parliament within 60 days of the entry into force of the same (i.e. 7 January 2010).

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### **Latvia – Amendments to Latvian corporate tax deductions on interest payments**

Latvian corporate tax deductions on interest payments are currently restricted by statutory limits. However, these restrictions do not apply to interest paid on credits, finance leases and borrowings from credit institutions registered in Latvia or elsewhere in the EU and from Latvian residents.

The fact that interest payments to Latvian residents are fully deductible allows companies to claim a full tax deduction on interest they pay to countries with which Latvia has an effective double tax treaty by virtue of its anti-discrimination article.

Full deductibility of interest payments to any Latvian residents only has been found discriminatory under the EC Treaty, and the European Commission has formally notified Latvia of this finding in case No. 2007/2459. The Corporate Income Tax Act has been amended to comply with the request for eliminating the discrimination. However, the amendments do not favour businesses. The following interest payments will be fully deductible:

- Interest paid on borrowings from credit institutions resident in Latvia, the EEA or countries with which Latvia has an effective double tax treaty;
- Interest paid to the Latvian Treasury, Nordic Investment Bank, European Bank for Reconstruction and Development, European Investment Bank, European Council Development Bank and the World Bank Group;
- Interest paid on borrowings from a financial institution that:
  - is resident in Latvia, the EEA or a country with which Latvia has an effective double tax treaty; or
  - provides lending services or finance leases and is monitored by regulatory bodies in charge of credit institutions or the financial sector in the particular country;
- Interest paid on Latvian or EEA debt securities in public trading; and
- Interest expenses incurred by credit institutions and insurance companies, regardless of the lender.

As a result, restricted tax deductions will apply to interest paid to Latvian residents that do not meet these criteria. It will no longer be possible to use the anti-discrimination article of double tax treaties, and interest paid to any lenders other than those listed above will fall under the restrictions of the Corporate Income Tax Act. This may turn out to be an issue for EU parent companies having Latvian subsidiaries with an insufficient debt-equity ratio that are currently relying on double tax treaties for full deductions on interest payments.

The amendments will apply from the tax period starting in 2010.

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### **Norway – Norwegian Government amends the application of the tax exemption method in EU / EEA situations, ready to grant dividend withholding tax refunds**

The Norwegian tax authorities have over the last few years interpreted the domestic tax exemption method narrowly, and several non-resident tax payers have been excluded from its scope of application. The Norwegian Ministry of Finance has conceded that foreign investors have been taxed in violation of EC Law and will now grant dividend withholding tax refunds.

A qualifying resident company receiving dividends from a Norwegian company is exempt from tax on the dividend income. According to the Norwegian Tax Act, a foreign company resident within the EEA is exempt from dividend withholding tax. The exemption is only available if the foreign company is “actually established and conducts genuine economic activity” within its state of residence. The tax authorities have argued that since all qualifying Norwegian entities are liable to tax in Norway, and as such resident for tax treaty purposes, the same requirements must be met by foreign entities in order to claim a refund of dividend withholding taxes under EEA law. Otherwise, they would not be comparable to any Norwegian entities and thus no discrimination would exist.

The Norwegian tax authorities have consistently over the last years denied Luxembourg SICAVs and similar entities refunds for dividend withholding taxes. As SICAVs are not covered by the EU’s Parent-Subsidiary Directive, the Ministry of Finance held that their position could not be a violation of EEA law.

In a letter to the Directorate of Taxes dated 29 September 2009, the Ministry of Finance conceded that their previous interpretation of EEA law can no longer be upheld in light of the *Aberdeen* decision. [\(C-303/07\)](#) In addition, the Ministry clarified certain aspects of the application of the substance requirement. Most importantly, the Ministry explicitly states that whether or not the foreign entity is subject to corporate income tax in its state of residence is irrelevant when determining if the foreign entity is covered by the Norwegian tax exemption method.

With reference to the legislative history dating back to the introduction of the tax exemption method, the Ministry lays down the following requirements that foreign entities have to fulfil in order to be covered by the tax exemption method:

- The entity must be a separate tax entity as determined under Norwegian law; i.e. the owners' liability must be limited to the paid in capital;
- The entity must otherwise be comparable, but not identical, to a Norwegian qualifying entity; this presumably refers to the company law and regulatory regime governing the foreign entity;
- The income must be properly attributable to the foreign entity as determined under Norwegian legal principles; and
- The entity must meet the substance requirements (see below).

The Ministry of Finance provides some clarification as to how the substance requirement should be applied. The substance requirement was introduced in the aftermath of the ECJ's decision in the Cadbury Schweppes ([C-196/04](#)) case. The preparatory works provides a substantive set of considerations that have to be taken into account when assessing whether a foreign entity is "actually established and conducts genuine economic activity" in its state of residence. The tax authorities have applied the substance requirement vigorously, without much regard for the type of activity performed or regulatory constraints that the foreign entity is facing. The Ministry now states that foreign equity funds may fulfil the substance requirement even if the fund itself has no substance as long as the management company of the fund meets the requirements. Furthermore, the substance requirement also applies to outbound investments in low tax jurisdictions in the EEA. Thus, the clarification of the substance requirement will make it more attractive for Norwegian investors to invest in equity funds in jurisdictions such as Luxembourg.

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### **Poland – Polish Government ends discriminatory legislation on dividend and interest payments of foreign EU / EEA pension and investment funds before end of 2009**

On 6 July 2009, the Polish Government issued a reply to the European Commission's Reasoned Opinion, which was sent to Poland on 15 May 2009 regarding its discriminatory taxation of foreign pension funds and investment funds, in which the Government acknowledges that its legislation is in breach of EC Law.

On 23 March 2009, the Commission sent Poland a first request for removing the breach of Articles 43, 48, 49 and 56 of the EC Treaty. The Commission argues that Poland is in breach of EC Law, since the Polish corporate income tax law ("CIT Law") results in a higher taxation of dividends and interest paid to EU / EEA based pension funds and investment funds compared to dividends and interest paid to Polish funds. The questioned provisions encompass Art. 6 sec. 1 point 10 and 11 of the Polish Corporate Income Tax Act (CITA).

In the reply to the Commission, the Polish Government also recognises that certain kinds of income paid to foreign tax resident funds in Poland are subject to taxation at source, whereas domestic funds benefit from a subjective tax exemption in Poland. The Government will introduce appropriate amendments to the CITA which should come into effect on 1 January 2010.

Consequently, foreign pension and investment funds have strong arguments to claim that withholding tax remitted in the past from dividends and interest paid thereto was imposed contrary to EC Law. Hence, foreign EU / EEA pension funds and investment funds investing in Poland may apply for a refund of withholding tax levied in previous years as far back as 1 May 2004.

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### **Spain – Spanish Government to align legislation on EU pension funds and calculation of taxable base of non-residents without a PE with EC Law by 1 January 2010**

On 9 October 2009, the Spanish Government submitted a Bill to parliament relating to some amendments of the Spanish income tax legislation to EC Law, including the treatment of non-resident EU based pension funds and the calculation of the taxable base of non-residents without a PE in Spain. The Bill will normally enter into force on 1 January 2010.

The government Bill sets out a tax exemption on dividends distributed by Spanish entities to foreign EU pension funds (equivalent to pension funds formed under domestic law and under EU Directive 2003/41/EC, also known as the IORPs Directive, subject to certain conditions) or to PEs of said pension funds located in another EU Member State. The measure aims to end Spain's discriminatory taxation of foreign EU based pension funds in Spain. However, it should be noted that the Bill does not cover dividends distributed to EEA countries, nor does it cover third countries.

This is a welcome new development, as the European Commission had referred Spain already to the ECJ in November 2008 for its non-compliance with EC Law in this respect. The Commission's action was based on a joint complaint filed by EFRP and PwC with the Commission in 2005 against Spain and a number of other EU Member States. EU Pension funds which have filed "protective" refund claims in Spain in a timely and correct manner should be affected positively by this change of legislation. To safeguard their rights for previous years and for the future, EU pension funds could consider filing protective refund requests in line with local statutory time limits. The same applies to non-resident EEA and also third country pension funds in Spain, as the Commission will probably continue the procedure or start a new one against Spain regarding EEA and third country based pension funds.

Regarding the changes to the calculation of the taxable base of non-residents without a PE in Spain, at the moment, in Spain non-residents are taxed on a gross basis, without deduction of expenses. The modification of the rules aims to tax said income on a net basis (income less expenses) as if they were tax residents in Spain rather than on a gross basis. The deductibility of said expenses will be allowed to the extent that the taxpayer produces evidence that they are directly related to the income realised in Spain and that there is an underlying direct economic connection between such expenses and the activity carried out in Spain, provided that those non-residents are residents of an EU Member State. This Bill constitutes a relevant issue for residents of other EU Member States who might obtain income in Spain (e.g. royalties or others) as their final tax liability will improve.

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## **Sweden – Swedish Government proposes to introduce limited “group deduction” for foreign tax losses**

On 11 March 2009, the Swedish Supreme Administrative Court ruled that a Swedish parent company will obtain a tax deduction for final losses suffered by subsidiaries within the EEA, if the losses cannot be used in the other country, but only if the subsidiary is dissolved through liquidation. It was thus clear that the Swedish group relief system (Sw. “*koncernbidrag*”, group contributions, ie. an income transfer payment) was not fully in line with the freedom of establishment laid down in the EC Treaty.

The Swedish Government has now announced that it intends to amend the legislation as of 1 July 2010 (assuming that the rules are approved by the Parliament) to be applicable to fiscal years ending after 30 June 2010. In a government White Paper released on 22 September 2009, the Government states that no change of the group contribution system should be made. An alternate system, a so-called group deduction (Sw. “*koncernavdrag*”), will instead be introduced to make the Swedish group relief system compliant with the EC Treaty.

According to the draft Bill a Swedish parent company will be able to deduct final losses in a directly held subsidiary within the EEA when the subsidiary has been dissolved through liquidation. Several requirements will have to be met. Amongst others the following are worth mentioning. The losses in the subsidiary must have been incurred during a period when the Swedish parent company has been the direct owner of more than 90 per cent of the shares. No deduction will be allowed if the group continues to hold another subsidiary resident in the same country as the dissolved subsidiary. Unlike the group contribution system, the group deduction will not be tied to the transfer of funds. The losses in the foreign subsidiary should be calculated both according to foreign and Swedish tax rules and the lesser amount of the two is the maximum deduction available. And finally, the Swedish parent company can not deduct a higher amount than the parent company’s own taxable profit (before the group deduction) in Sweden.

It is clear that the requirements stipulated in the draft Bill will be hard to meet and it is equally clear that the Swedish Government’s view is that as few deductions as possible should be granted. The burden of proof for showing that all requirements are met lies with the Swedish parent company. Surprisingly, the Swedish Government explicitly states that the group has to consider – and carry out - all available tax planning activities abroad in order to ensure that the foreign losses could be utilised abroad before any tax deduction is granted in Sweden. “Sophisticated tax planning” abroad, however, should not be necessary, the Government adds. The Swedish Government is of the opinion that the amended rules will be EU compliant. This is, however, far from clear and it cannot be ruled out that there will be upcoming court cases challenging the new rules in the future.

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## **United Kingdom – Consortium loss relief rules found contrary to EC Law**

The case of *Philips Electronics UK Limited v The Commissioners for HMRC* concerned a claim by a UK resident member of an ultimately Dutch-owned group for relief for the group's share of

UK losses attributable to a UK PE of a Dutch resident and incorporated joint venture company in which the group had participated. The UK legislation did not provide for this, as it required the 'link' company (i.e. the company which is both a member of the group and a member of the consortium) to be resident in the UK, whereas in this case the 'link' companies were Dutch and German resident companies.

In a decision dated 18 August 2009, the First-Tier (tax) Tribunal concluded that the requirement for a UK resident link company is in breach of Article 43 EC and cannot be justified, and therefore has to be disapplied. Clients with similar consortium interests with a non-UK resident link company should therefore consider whether they can now claim losses which were not previously available.

The First-Tier Tribunal also held that UK group relief rules in ICTA 1988 s403D(1) concerning relief for the UK losses of non-UK resident companies should be disapplied. This provision prevents UK group relief for a UK loss of a UK PE of a non-UK resident company if any part of the loss is deductible in any period against non-UK profits of any person. Note that although the case in issue concerned a consortium, this provision is applicable for group relief generally and is not restricted to consortium cases.

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#### **United Kingdom – Marks & Spencer cross-border loss relief - Quantum of losses**

In a decision released on 1 May 2009 the First-tier Tribunal found in favour of Marks & Spencer plc (M&S) regarding the group's cross-border loss relief claims. However, although the claims were allowed in principle, the First-Tier Tribunal did not decide the precise quantum of the group relievable losses. This was the subject of a separate hearing before the First-Tier Tribunal in July 2009. In September the First-Tier Tribunal issued a decision in favour of the taxpayer, holding that the amount of the loss available for surrender as group relief, and the timing of the relief, should be calculated on UK tax principles. Clients intending to make such claims should now be in a position to finalise them. Both of these decisions are being appealed by HMRC to the Upper Tribunal, and a hearing has been scheduled for March 2010.

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## ***EU DEVELOPMENTS***

### **EU – Lisbon Treaty enters into force on 1 December 2009**

The stalled Lisbon Treaty, intended to make the enlarged EU more democratic and efficient, was adopted by the Irish people on 2 October 2009 by 67.1% yes versus 32.9% no. The turnout was 58%. The yes turn around amazed many in Ireland. A yes vote was expected but not this high. The focus subsequently switched to the presidents of Poland and the Czech Republic, who still needed to sign the treaty after their parliaments had ratified it already. The

signing by the presidents was the last hurdle before the reform treaty could finally enter into force, at the latest on 1 January 2010.

Polish President Kaczynski signed the treaty a week after the Irish vote leaving his Czech counterpart Klaus as the only remaining stumbling block to the treaty's entry into force.

At Czech President Klaus's instigation, in mid-September 2009, 17 senators lodged a complaint with the Czech constitutional court to check whether the Lisbon treaty and preceding EC/EU treaties are compatible with the Czech constitution and clarify whether the Irish legal guarantees on taxation, neutrality and abortion agreed by EU leaders in December 2008, and confirmed in June 2009, constitute a new international treaty which requires ratification by the Czech parliament. This move was clearly a delaying tactic as the Irish guarantees, especially on taxation, were actually nothing more than a reiteration of the status quo (that is, unanimity voting on taxation in Council) to reassure the Irish voters ahead of the second referendum on the treaty. The Irish guarantee on taxation reads: "Nothing in the Treaty of Lisbon makes any change of any kind, for any member state, to the extent or operation of the Union's competences in relation to taxation".

Earlier, in June 2009, a group of German lawmakers also tried to halt the treaty by asking the constitutional court in Karlsruhe to confirm whether the new EU treaty was compatible with the German constitution, which the court affirmed. At the same time, the constitutional court ruled that the Bundestag's role in the implementation of EC Law needed to be strengthened.

President Klaus kept EU leaders in suspense by demanding at the last minute a national opt-out from the Charter of Fundamental Rights, which is incorporated into the new treaty, to ensure that Czech ratification does not lead to future property claims by ethnic Germans expelled from Czechoslovakia after 1945. EU leaders accepted the Czech opt-out at their summit meeting on 29-30 October 2009, clearing the way for final ratification by President Klaus. The Czech constitutional court finally endorsed the treaty on 3 November 2009 and Klaus signed the treaty a few hours later.

The Czech president's delay has nevertheless affected a series of important decisions including the formation of the new Commission, which was originally planned to be set in motion at an European Council meeting at the end of October. The outgoing Commission's mandate expired on 31 October 2009 but it was decided earlier in October already that it can stay on in a caretaker capacity until 1 January 2010 with an option to extend this for a number of months if the nomination and appointment process of the new commissioners and their approval by the European Parliament incur further delays.

The Lisbon treaty will come into force on 1 December 2009. The Irish legal guarantees and the Czech opt-out are annexed to the new treaty and will be formally annexed as a protocol (integral treaty part with full legal status) as soon as the next EU Accession Treaty is signed.

In the meantime, many pending Commission initiatives in the field of direct taxation, for instance on the EU's Interest and Royalties and Merger Directives, are already expected to be

delayed for several months because of the wait for a new Commission and the strong EU focus on the financial crisis.

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## **EU – Lame duck European Commission, New EU Treaty**

The European Commission's 5-year mandate officially expired on 31 October 2009, however, as decided by internal EU institutional procedure, the EU's executive body can stay on in a caretaker capacity until the appointment process of the new Commission has been completed. With the protracted ratification process of the Lisbon Treaty finally out of the way on 3 November 2009 and after the formal choice of the EU's first 'permanent' European Council President and top diplomat was made, EU leaders and re-appointed Commission President Barroso could fully focus on the appointment of the new team of Commissioners and the distribution of policy portfolios in the second half of November 2009.

The 26 EU Commissioners-designate, nominated by their national governments but nominally independent, were presented by Commission president-elect Barroso in the last week of November 2009. Each of the Commissioners will be quizzed during formal hearings at the European Parliament expected to start on 11 January 2010. The Parliament will either endorse or reject the full College of Commissioners in a plenary vote on 26 January 2010. If endorsed by Parliament, the "Barroso II" Commission is expected to start its work immediately. Until then, however, the EU executive is a lame duck with its activities limited to, basically, "current affairs". In the field of direct taxation, this means that no new Commission proposals will be initiated. Pending proposals on the EU's Interest and Royalty and Merger Directives, the exit tax resolution, cross-border mergers of funds and the European private company statute, have been temporarily put "on hold". Even so, political agreement may be reached in December 2009 on the new Savings Directive due to the strong EU focus on combating the financial crisis and promoting good tax governance, and, possibly, on the pending proposals for directives on mutual assistance and administrative cooperation.

The proposed new Tax Commissioner, Algirdas Semeta (Lithuania), who is thoroughly briefed and prepared for the European Parliament hearing by the Commission's Services, will, once in office, and after due consultations, set the direct tax priorities for the next five years. He could even decide to put the CCCTB project back on the agenda although this is politically very sensitive. He will in any case start working in a new treaty context: the Treaty on the Functioning of the European Union (TFEU) or Treaty of Lisbon.

The implications for direct tax under the Lisbon Treaty are minimal, primarily as a result of the incorporation of the Irish legal guarantee on taxation, and there are no material changes to the fundamental freedoms. A new paragraph 4 has been added to Article 58 EC regarding the free movement of capital between EU and third countries which allows the Commission or Council to adopt restrictive tax measures adopted by a Member State concerning one or more third countries as long as they can be justified by one of the objectives of the Union and are compatible with the proper functioning of the internal market. The big question remains, apparently also for most EU officials, which is rather worrying, what this legalistic provision will mean in practice.

As has become tradition, with each new consolidated version the treaty article numbering has changed as well: Art. 39 EC (workers) is now Art. 45 TFEU; Art. 43 EC (establishment) is now Art. 49 TFEU; Art. 49 EC (services) is now Art. 56 TFEU; and Art. 56 EC (capital) is now Art. 63 TFEU. The State aid prohibition previously covered under Art. 87 EC is now covered under Art. 107 TFEU.

Another treaty change concerns the provision on “enhanced cooperation” which could for instance be used for implementing the CCCTB only in a select number of EU Member States. The minimum number of participating countries is now set at nine, and instituting this procedure is subject to a Council qualified majority decision and consent of the European Parliament. It is believed that the existing draft Commission proposal on the CCCTB, which was frozen “until further notice” in August 2008, and on which some further work appears to have been done by the Commission’s CCCTB Task Force, is unlikely to be changed significantly anymore by the Commission. If the CCCTB proposal is indeed put back on the agenda by the new Tax Commissioner and ultimately supported by a critical mass of 9 Member States, the implementation and fine-tuning of it is expected to be done through the EU’s “comitology” procedure, whereby the Commission executes its implementing powers conferred to it by the Council and Parliament, with the assistance of a national expert committee.

The Commission’s Services intend to publish a comprehensive strategic policy paper on EU direct tax policy in mid- 2010. Whether CCCTB will be included as part of the new EU tax strategy depends in large part on the priorities of the incoming EU Tax Commissioner.

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### **Netherlands – European Commission recommends simplified procedures for claiming back cross-border withholding tax relief**

On 19 October 2009, the European Commission adopted recommendations to Member States to make it easier for investors resident in an EU Member State to claim back withholding tax relief on dividends, interest and other securities income received from other Member States.

National refund procedures across the EU are often so complicated and time consuming that investors may forego the reliefs to which they are entitled, or be discouraged to invest in other Member States. To reduce this dissuasive effect, the Commission recommends Member States to:

- Apply at source rather than by refund any withholding tax relief applicable to securities income under double taxation treaties or domestic law;
- Accept alternative proofs of investors’ entitlement to tax relief besides certificates of residence. Such alternative proofs could include self-certification by the investor and/or residence documentation gathered by financial intermediaries. For instance, when an investment firm provides investment advice and discretionary portfolio management to its clients, it is required under the Financial Instruments Directive 2004/39/EC to obtain information about its clients/investors. The Recommendation suggests that tax

- authorities might, in particular, find these alternative proofs sufficient in the case of small claims, for example claims of less than €1,000;
- Consider its suggestions as to how Member States can involve financial intermediaries in making claims on behalf of investors and, in particular, where there is a chain of financial intermediaries, in different Member States, between the issuer of the securities and a beneficiary. For example, it is suggested that financial intermediaries should only have to pass on "pooled" withholding tax rate information (i.e. information in a format which groups securities income according to the withholding tax rate applicable without identifying the owners of the securities) to the next financial intermediary in a custody chain;
  - Apply simplified tax refund procedures where investors are not able to obtain WHT relief at source, provided that all necessary information is available. In this respect the Commission explicitly recommends the granting of refunds within a period of 6 months;
  - Allow claims to be filed electronically and using common formats for filing such claims.

The Commission's recommendations should make it easier for investors to obtain an immediate relief at source, or obtain a withholding tax refund within 6 months after claims have been filed. This EU Recommendation is not legally binding. According to the Commission, Member States are already moving towards less complicated procedures and by publishing this Recommendation the Commission aims at stimulating this trend.

The Commission Recommendation echoes the report that was published by the OECD working group earlier this year. Representatives of the Commission are participating in the ongoing work at the OECD. The OECD Report is available at:

<http://www.oecd.org/dataoecd/34/19/41974569.pdf>

See also EUDTG [Newsalert 2009 – nr 024](#).

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### **Belgium – European Commission requests Belgium to end its discriminatory taxation of dividends from bearer shares, dematerialised shares and foreign investment companies**

On 8 October 2009, the European Commission requested Belgium by means of a reasoned Opinion to end its discriminatory taxation of dividends from bearer shares, dematerialised shares and foreign investment companies (case reference number 2008/4084).

As a general rule, dividends are subject to a 25% Belgian withholding tax, while a reduced withholding tax rate of 15% may apply in some cases.

As regards bearer shares and dematerialised shares, a reduced withholding tax rate of 15% is applicable to dividends of shares which were the object since their issuance:

- (for bearer shares) of an uncovered deposit in Belgium, under certain conditions, with a Belgian financial institution subject to the control of the Belgian regulator;

- (for dematerialised shares) of a registration in an account in Belgium, in the name of its owner, with an authorised settlement entity or accountholder; when these shares were issued as from 1 January 1994, represent the share capital and were subscribed in cash.

In addition, a 15% withholding tax rate applies to dividends distributed by Belgian publicly offered investment companies.

Considering that the above reductions of withholding tax do not apply, respectively, to shares held abroad or to foreign investment companies, the Commission considers that the Belgian legislation constitutes a breach of the free movement of capital (Article 56 EC) and the freedom to provide services (Article 49 EC) and therefore requests Belgium to amend its legislation.

Additional municipal charges are levied only when foreign sourced movable income is paid directly to Belgian individual taxpayers without the intervention of a Belgian financial intermediary. In the case of Belgian sourced dividends, these additional municipal charges are generally not due. This breach of the free movement of capital (Article 56 EC) was recently brought before the ECJ in Case C-233/09, *Dijkman v. Belgische Staat*.

Belgian individuals who have suffered a 25% taxation on foreign sourced dividends and/or additional municipal charges on foreign movable income payments should consider introducing claims in order to protect their rights.

Belgium has two months to reply to the Commission's Reasoned Opinion.

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### **Estonia – European Commission starts infringement procedure against Estonia over real estate income received by non-resident contractual funds**

According to the Estonian Ministry of Finance, a new infringement procedure has been initiated by the European Commission against Estonia in October 2009 concerning its discriminatory treatment of real estate income received by non-resident contractual funds.

Although the details of the infringement procedure are not public, it can be assumed that infringement procedure relates to the discriminatory treatment of gains from the alienation of real estate, gains from the alienation of shares in a real estate company as well as rental income. All those are subject to 21% tax when received by foreign funds, while domestic contractual funds are exempt from any tax.

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### **Germany – European Commission formally requests Germany to end discrimination on outbound dividends and interest payments to foreign pension institutions**

On 29 October 2009, the European Commission announced its decision to send a Reasoned Opinion to Germany to amend its discriminatory legislation regarding outbound dividends and

interest payments to foreign pension institutions. The Reasoned Opinion is the second step of the EU's infringement procedure ex Article 226 EC Treaty. A first request was sent to Germany by the Commission on 31 January 2008. See also EUDTG Newsalert [NA 2008-006](#).

The decision regards Germany's rules on the taxation of "Pensionskassen" and "Pensionsfonds" and their corresponding institutions established in the EU and EEA. As to "Pensionskassen", dividends paid by German companies to German "Pensionskassen" are either subject to a reduced withholding tax rate, or the "Pensionskasse" can benefit from a partial refund of the withholding taxes. However, similar institutions established elsewhere in the EU and the EEA cannot benefit from this reduced rate or partial refund and are subject to a final withholding tax of 26,375 %.

Dividends received by German "Pensionsfonds" are taken into account in the annual tax assessment procedure and are taxed on a net basis after deducting premium reserves at the general corporate tax rate of 15,825 %. However, dividends paid from a German company to similar foreign institutions are subject to a final withholding tax of 26,375 % on the gross dividend, without the possibility of deducting any costs.

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

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### **Portugal – European Commission requests Portugal to amend its restrictive exit tax provisions for individuals**

Based on article 10 (8) of the Portuguese Personal Income Tax (PIT) Code, in case of a qualifying share for share exchange, there will be no taxation of any capital as far as shares received are valued for tax purposes for the value of the shares handed over. However, according to Article 10 (9) (a) of the PIT Code, any capital gains arising from the exchange of shares will be included in the shareholder's taxable income of the tax year in which he ceases to be resident in Portugal. In this circumstance, the capital gain will correspond to the difference between the market value of the shares received and the tax value of the shares handed over.

On the contrary, if the shareholder continues to be resident in Portugal, the value of the shares received will be considered equal to the value of the shares handed over, and there will only be a taxable gain if the shareholder receives any additional payment in cash arising from the exchange of shares.

Moreover, article 38 (1) (a) of the PIT Code states that the transfer of assets and liabilities related to an economic or professional activity to a company by an individual is tax exempt, if the respective company has its head office or place of effective management in Portugal. If the

company has its head office or place of effective management abroad, this transfer will be taxed.

The Commission considers that the difference of treatment of individuals that leave Portugal or transfer their assets abroad comparing to individuals that remain in Portugal or transfer their assets domestically constitutes a restriction on the freedom of establishment and, as a result, constitutes a restriction of Articles 18, 39 and 43 EC Treaty and the corresponding provisions of the EEA Agreement.

The Commission's opinion is based on the ECJ judgment of 11 March 2004 in Case C-9/02, *De Lasteyrie du Saillant*, and the Commission's Communication on exit taxation (COM (2006) 825) of 19 December 2006). The Commission's case reference number is: 2007/2365. The Commission's case reference number is: 2007/2381.

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## **STATE AID**

### **Germany – European Commission decision on German tax law on risk capital**

On 1 October 2009, the European Commission announced that parts of the German Law to Modernise the General Conditions for Capital Investments (MoRaKG) are not compatible with the EU Risk Capital Guidelines and with the principle of freedom of establishment.

On 18 August 2008, MoRaKG had been adapted into German law under the proviso of compatibility with EU State aid principles. On 29 January 2009, the Commission opened an indepth investigation into MoRaKG (see [EUDTG Newsletter 1/2009](#)).

The Commission partly confirms the compatibility of MoRaKG with EC Law but also concludes that the following two regulations constitute prohibited State aid:

- As an exception from regular German loss utilization rules, the acquisition of a Target Enterprise by a Venture Capital Company would not lead to a loss forfeiture if both companies met the requirements according to MoRaKG. Since other target enterprises and risk capital investors that fall outside the scope of MoRaKG would not benefit from this derogation, the Commission in this regulation finds a selective advantage which is prohibited according to State aid principles.
- As a second critical measure, the income of a Venture Capital Company established as a partnership would be deemed property management income and consequently be exempt from trade tax. In contrast to this, profits of other partnerships which are not entitled under the MoRaKG, would be liable to trade tax. The Commission is of the opinion that such a selective advantage is not compatible with the Single Market, as it

would give certain Venture Capital Companies and Target Enterprises an unfair advantage over their competitors, who have to operate without such aid.

Moreover, the Commission stated that the regulation also infringes the principle of freedom of establishment, as the aid is only granted to Venture Capital Companies having their seat and corporate management in Germany.

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### **Hungary – European Commission decision on Hungarian intra-group interest taxation**

The European Commission has concluded the investigation it launched in February 2007 into the competition-neutrality of a corporate tax deduction in Hungary of up to 50% of the net interest income from loans between related-entity companies.

On 30 October 2009, the Commission decided that the Hungarian rule is contra-competitive because some Hungarian companies are not entitled to make use of the measure (e.g. financial and small enterprises), and as such it constitutes State aid. The good news is that the rule is classified as existing State aid because the Hungarian regime was introduced before Hungary acceded to the EU, and uncertainties regarding the qualification of the scheme as State aid at the time of its introduction. Generally, decisions of the Commission relating to existing State aid do not have a retroactive effect i.e. there should not be a requirement for companies who benefitted from this provision to make repayments of the benefit.

It appears unlikely that the Commission will open further procedures since Hungary has in the meantime repealed the tax deduction effective 1 January 2010, and therefore, unless stated otherwise in the decision, the corporate tax base deduction may still be used for fiscal year 2009.

See also EUDTG [Newsalert 2009 – nr 026](#).

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### **Italy – CFI judgment on Italian measure favouring newly listed companies**

On 4 September 2009, the CFI rejected a request submitted by Italy for the annulment of the European Commission's decision regarding an aid granted by Italy to certain newly listed companies (case [T-211/05](#)).

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

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

- A *de facto* double deduction of the admission to trading costs.

By means of the contested decision Nr. 2006/261/EC of 16 March 2005, the Commission declared the measure at hand was an aid, within the meaning of Article 87(1) of the EC Treaty, and incompatible with the EU's Common Market, as:

- it confers an advantage, consisting of the reduction of the taxable base and the tax burden suffered by certain companies;
- the advantage is selective since it favours only the companies that are able to obtain a listing during the period required by the same measure;
- the advantage is conferred by the State in the form of foregoing of tax revenues normally collected by the Italian Treasury;
- the measure is liable to affect trade between Member States and distort competition between companies as the beneficiaries may be operating on international markets and be involved in trade and other business activities in markets where competition is intense;
- none of the exceptions provided for in Article 87(2) and (3) EC applies to the scheme.

As the measure was not notified before its implementation, the Commission also ordered its recovery from the (ten) beneficiaries (the aid was roughly estimated in EUR 11.7 m for each beneficiary). The CFI confirmed the Commission's decision rejecting all the pleas submitted by Italy.

With its judgment, the CFI has established that the advantage:

- is selective because the same was limited to certain given undertakings (listed companies) and mainly favoured companies registered in Italy;
- is not justified by the nature or the overall structure of the tax scheme of which it forms part;
- is not linked to specific investments, job creation or specific projects, therefore the same has to be considered as an operating aid. In fact for the CFI, listing on the stock exchange itself is not a specific investment, since it does not constitute expenditure on tangible or intangible investment or expenditure on the recruitment of new staff in connection with a new investment.

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### **Portugal – CFI judgment on tax incentives in the Autonomous Region of Azores**

On 10 September 2009, the CFI rejected an action brought forward against the European Commission by Banco Comercial dos Açores, S.A., claiming the annulment of Commission decision 2003/442/CE which considered the reduction of the corporate income tax (CIT) for entities resident in the Autonomous Region of the Azores performing financial and “intra-group” (coordination, treasury and distribution) activities (Section J, Codes 65, 66, 67 and Section K, Code 74 of NACE Rev. 1.1), incompatible with Article 87 EC (State aid).

The incentive approved by the Regional Assembly of Azores stipulated a reduction of 30% of the general CIT rate applicable in (mainland) Portugal, for all entities resident in the Autonomous Region of Azores.

The CFI ruled that:

- The Regional Government did not have sufficient autonomous powers from the Portuguese Central Government to be able to decide to reduce the CIT rate in Azores;
- The incentive must be assessed in relation to the whole Portuguese territory, and in this circumstances it appears to be selective;
- The incentive can affect trade and distort competition between Member States; and
- The tax incentive was conceded without prior approval from the Commission, and therefore the principles of protection of legitimate expectations and legal certainty were not infringed.

The CFI decision follows the ECJ's judgment of 6 September 2006 in Case [C-88/03](#) regarding the same matter, which considered these incentives not compatible with EU State aid rules.

The corporate income tax legislation in the Autonomous Region of Azores has not yet been adapted in accordance with the Commission's decision.

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### **Spain – European Commission decision on Spanish goodwill amortisation scheme**

On 28 October 2009, the European Commission announced that it requests Spain to abolish the goodwill amortisation scheme as laid down in article 12.5 of the Spanish Corporate Income Tax Act (SCITA). The Commission ruled that the regime provides for a selective advantage for Spanish companies acquiring foreign companies.

Article 12(5) SCITA provides that a Spanish company may amortise the financial goodwill resulting from the acquisition of a significant shareholding in a foreign company during the 20 years following the acquisition. This results in an economic advantage, amounting to the difference between the acquisition cost of the shares and the market value of the underlying assets of the target company.

Spain did not notify the scheme to the Commission before implementing it, which leads to the potential obligation for the Spanish Government to recover the aid granted if the scheme did breach the EC Treaty. Five years after implementing the regime, in October 2007, the Commission decided to initiate the formal investigation procedure in respect of the Spanish regime.

The Commission has ruled that the regime clearly constitutes a derogation from the general Spanish tax system, and that it provides a selective advantage for Spanish companies acquiring non-Spanish European companies as compared to Spanish companies acquiring shares in other Spanish companies. Given the fact that this selective advantage cannot be

justified by the general logic of the Spanish tax system, the Commission ruled that the regime at hand constitutes State aid within the meaning of Art. 87(1) EC.

In order to maintain a level playing field in the Single Market, especially in the context of competitive takeover bids, Spain must abolish the measure and recover unlawful aid given. However, the Commission decided to limit the scope of the recovery obligation and orders Spain to recover the incompatible aid granted only as of 21 December 2007, because of the existence of legitimate expectations.

As regards acquisitions in non-EU companies, a final decision has not been reached. Constructive discussions between the Commission and Spain are still ongoing, which could lead to the acceptance of a new regime which is compatible with EC Law requirements.

See also EUDTG [Newsalert 2009 – nr 025](#).

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### **Spain – CFI judgments on tax incentives approved by the Álava, Guipúzcoa and Vizcaya´s Basque Regional Councils**

On 9 September 2009, the CFI ruled that some tax incentives approved by Álava, Guipúzcoa and Vizcaya´s Basque Regional Councils are not compatible with Article 87 EC (State aid) as they affect trade between Member States and distort competition. The tax incentives approved by the Basque Regional Councils were the following:

- Corporate income tax credit of 45% on investments in new fixed assets made between 1 January 1995 and 31 December 1999 which exceeded ESP 2,500 million (EUR 15 m). Reference: Joined Cases T-227/01 to T-229/01, T-265/01 and T-270/01;
- Corporate income tax full exemption for a period of 10 years for companies set up between 1993 and 1994, provided that certain conditions were met, such as minimum paid-up capital, investment in tangible fixed assets, creation of employment, etc. Reference: Joined Cases T-30/01 to T-32/01 and T-86/02 to T-88/02; and.
- Corporate income tax base reductions for four years (99%, 75%, 50% and 25%), for companies that started their business activities from 1996 to 1999, provided certain conditions were met e.g. minimum paid-up capital, investment in tangible fixed assets, creation of employment...Ref: Joined Cases T-230/01-T-232/01, T-267/01- T-269/01.

The Court held that the main objective of the implementation of the said tax incentives, which was the encouragement of the investment in the Basque Territories, could not be achieved because it restricted the aid to a limited category of businesses.

There is still an opportunity for the Basque Authorities to submit an appeal against these judgments before the ECJ. In case that no appeal is submitted or that the ECJ delivers a final judgment in the case in similar format, the beneficiaries of the tax incentive measures will have to repay the State aid unlawfully granted in order to forfeit the advantage which they have enjoyed over their competitors on the market.

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The EUDTG is one of PricewaterhouseCoopers' Thought Leadership Initiatives and part of the International Tax Services Network. The EUDTG is a pan-European network of EU tax law experts and provides assistance to organizations, companies and private persons to help them to fully benefit from their rights under EC Law. The activities of the EUDTG include organising tailor-made client conferences and seminars, performing EU tax due diligence on clients' tax positions, assisting clients with their (legal) actions against tax authorities and litigation before local courts and the ECJ. EUDTG client serving teams are in place in all 27 EU Member States, most of the EFTA countries and Switzerland. See the EUDTG website for more information: [www.pwc.com/eudirecttax](http://www.pwc.com/eudirecttax).

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