EU Tax News

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ECJ CASES

Germany – ECJ referral on Germany's different depreciation method for buildings abroad: case

After not having reacted to the reasoned opinion of January 2008, the European Commission has decided on 19 March 2009 to refer Germany to the ECJ for its discriminatory tax depreciation rules applied to buildings situated abroad.

In general, assets are depreciated in fixed rates (linear). Under the former German Income Tax Act (sec. 7 par. 5 s. 3 ITA), domestic buildings that were used for rental housing could have been depreciated not linearly but in falling rates. In the first years, the depreciation rate was higher and in the last years lower than that of a linear depreciation. This different depreciation resulted in a tax deferral with a cash advantage. However, buildings abroad could only be depreciated in fixed rates. Especially in cases where a double tax treaty does not exist or only foresees the foreign tax credit method, the taxable income incurred of rental housing abroad was higher than that of domestic rental housing. In the Commission´s view, the investment in buildings situated abroad became less attractive and therefore found the German provision not in line with the free movement of capital. Although the depreciation in falling rates was abolished for buildings acquired from 1 January 2006 onwards, the Commission pursued the infringement procedure as the different depreciation method continues to have an effect for a period of up to 18 years.

-- Gitta Jorewitz and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Germany – ECJ referral on German withholding taxes on outbound dividends: case

On 19 March 2009, the Commission published a press release (IP/09/435) stating that it is referring Germany to the ECJ for its tax provisions concerning outbound dividend payments to foreign companies.

According to German law, dividends paid to German resident corporations are exempted from corporation tax, regardless of the amount of the shareholding. At the same time, 5% of the dividends are deemed non-deductible expense. As a result, dividends paid to German resident corporate shareholders are exempted from corporate taxation to 95%.

However, when dividends are paid to non-resident corporate shareholders, 26,375% withholding tax (including solidarity surcharge, until 2008: 21.1 %) is levied on the gross payment in a first step. Since 2009, foreign corporations can claim a refund of 2/5 of the withholding tax, if they fulfil specific requirements. In addition, the (residual) tax burden is reduced to zero if the Parent/Subsidiary-Directive is applicable, or if a double tax treaty states a zero rate for qualifying dividends. For other dividends, the withholding tax amounts to between 5% and 15% according to the relevant tax treaties. Thus, such dividends paid to non-resident corporate shareholders are taxed more burdensomely than dividends paid to resident corporate shareholders. In this respect, the German treatment is similar to that dealt with in the *Denkavit* case C-170/05 (see NA 2006 - 035) and in the *Amurta* case C-379/05 (see NA 2007 - 038).

The European Commission has formerly requested Germany to amend its tax legislation concerning such outbound dividend payments (press release of 23 July 2007, IP/07/1152). The Commission considers the higher taxation of the outbound dividends to be contrary to the EC treaty and the EEA agreement, as it restricts the free movement of capital and the freedom of establishment. As the German tax rules were not amended to comply with the reasoned opinion, the Commission has decided to refer the case to the ECJ.

-- Gitta Jorewitz and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Germany – AG opinion on German private pension rules: Riester Rente case (C-269/07)

On 31 March 2009, AG Mazak published his opinion in the case European Commission v. Germany. He comes to the conclusion that German private pension rules (Riester Rente) in sec. 79 to 99 GITA are not in line with the principle of free movement of workers: Article 39 of the EC Treaty.

In 2001, the German government adopted sec. 79 to 99 GITA in order to relieve pressure from the national social security system and encourage workers to voluntarily subscribe to private pension plans. As a beneficiary of this "Riester Rente"-program, the resident worker either receives additional benefits to his retirement provisions from the government or is allowed to deduct a higher percentage of his insurance expenses for tax purposes.

Based on Article 12 EC (non-discrimination on grounds of nationality), Article 18 EC (free movement) and Article 39 (free movement of workers), AG Mazak in his opinion criticised the following provisions of the "Riester Rente": First of all, non-resident workers who did not apply to be treated as residents are excluded from the benefits of the program. Such exclusion constitutes a discrimination against those foreign workers who did not meet the requirements to be treated as a resident according to sec. 1 para. 3 GITA.

Secondly, the denial of the possibility to use the capital for a purchase or construction of a dwelling that is located outside of Germany constitutes a discrimination of non resident workers. This discrimination can neither be justified by the need to ensure an adequate supply of housing nor by the risk of undermining the financial balance of the social security system that might occur if also real estate in other Member States had been privileged.

Thirdly, the obligation to pay back the private pension bonus in the case where the full German tax residency ends, constitutes an indirect discrimination of non resident tax payers, as they are more likely to leave the country for retirement compared to German citizens.

-- Stefan Ickenroth and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Greece – ECJ judgment on Greek rules on taxation of inbound dividends and foreign partnerships: Commission v Greece (C-406/07)

The ECJ ruled on 23 April 2009 that the discriminatory taxation of inbound dividends received by individuals as well as the taxation of non-Greek partnerships is incompatible with Articles 43

and 56 EC and articles 31 and 40 of the EEA Agreement. The decision follows a Commission referral of 5 July 2007.

The taxation of inbound dividends has been amended as from 1 January 2009. According to the previous regime, dividends distributed by Greek companies were exempt from taxation in the hands of the beneficiary irrespective of its legal form, residency or nationality. However, foreign sourced dividends received by Greek individuals were fully taxable with a credit provided for the withholding tax (WHT) on dividends paid abroad.

Pursuant to the new legislation both domestic and foreign dividends received by Greek individuals are subject to a final WHT at the rate of 10%. These provisions apply only in case of dividends distributed by Greek Sociétés Anonymes and foreign S.A.-equivalents. The taxation of profits distributed by other legal forms to Greek individuals is still discriminatory, since profits distributed by Greek EPEs (Limited Liability Companies whose capital is divided in parts instead of shares) are exempt from taxation, whereas profits distributed by foreign companies, which are not SA-equivalent are fully taxable with a credit been provided for the withholding tax paid abroad.

The ECJ ruled that the Greek tax rules according to which non-resident partnerships in Greece are taxed more heavily (25%) than those resident in Greece (20%) are contrary to Article 43 EC and Article 31 of the EEA Agreement. Greek partnerships are subject to income tax in their name (i.e. they are not transparent). In particular, 50% of the profits of partnerships are taxed in the entity's name at the rate of 20%. In cases where there are individual partners the remaining 50% of the profits is considered as entrepreneur’s fee and is deducted from the partnership’s net profits for up to 3 individual partners owning the greatest percentages of participation to the partnership. This fee is determined by multiplying the percentage of participation to the partnership with the 50% of the partnership’s net profits, and is further taxed in the partner’s name according to the income tax scale applicable to individuals. Where all partners are legal entities the partnership's total profits are taxed in its name. However, branches of foreign partnerships are subject to Greek corporate tax at the rate of 25% like Greek corporations.

Although to date it appears that there is no non-Greek partnership operating in Greece, a draft law, introduced before the ECJ handed down its judgment, amends the taxation of non-Greek partnerships. According to the draft provisions, non Greek-partnerships will be taxed in a way similar to Greek partnerships

-- Vassilios Vizas and Stavroula Marousaki, Greece; alexandros.sakipis@gr.pwc.com

Italy – ECJ referral on Italian tax rules on tuition fees paid by individuals: Emiliano Zanotti v Agenzia delle Entrate case (C-56/09)

On 9 February 2009, the Provincial Tax Court in Rome (*Commissione Tributaria Provinciale di* Roma – first degree judge) made a referral to the ECJ concerning the compatibility with the EU Law of the Italian tax rules on the deductibility of the tuition fees paid by individuals.

Section 15, paragraph 1, lett. e) of the Italian Tax Code provides that the tuition fees paid by an individual can be deducted for tax purposes from the total amount of the taxes due within the limit of 19% of their amount.

As clarified by the Italian Tax Authorities by means of the Circular letter dated 12 May 2000, Nr. 95, the afore-mentioned tax provision is also applicable in the case of courses attended at foreign or private schools but the amount on which the 19% has to be calculated is not the effective amount paid but the one which would have been paid for similar courses attended at Italian public schools.

The Provincial Tax Court in Rome asked the ECJ whether such tax rule and the relevant interpretation made by the Italian Tax Authorities are in breach of the general principles of the EC Treaty and of the EU Law regarding the full and effective judicial protection, the equal treatment and the freedom of movement within the Community area.

It is highly important to stress that this is one of the few cases where an Italian Tax Court makes a referral on the compatibility of an Italian tax rule with a fundamental freedom protected by the EC Treaty. In addition, it is also interesting to point out that in the case at hand the referral was made by a Court that is not a Supreme Court.

-- Claudio Valz and Luca la Pietra, Italy; claudio.valz@it.pwc.com

Poland – ECJ judgment on non deduction of health premiums: Uwe Rüffler case (C-544/07)

On 23 April 2009, the ECJ ruled that national law that grants an income tax reduction for health insurance contributions paid domestically but refuses an income tax reduction for health insurance contributions paid in another EU Member State breaches Article 18(1) of the EC Treaty.

The claimant Uwe Rüffler used to live in Germany and be employed there. When he retired, he moved to Poland. Mr Rüffler does not carry out any business activity in Poland. He received a pension paid by a German employer. The pension was subject to Polish income tax. Article 27b of Poland's Law of 26 July 1991 on income tax payable by individuals allows a reduction for part of health insurance contributions but only if the contributions are paid in Poland. Mr Rüffler applied to the Polish tax authorities for a reduction in his Polish income tax to reflect the amount of health insurance contributions he had paid in Germany. As the tax authorities rejected his application, the case was brought before the Regional Administrative Court of Wroclaw. The court asked the ECJ to rule whether the limitation discussed is compatible with EC law.

The ECJ decided that the Polish income tax legislation in this respect treats resident taxpayers differently based on the source of health insurance contributions that they pay, i.e. Poland or another EU Member State. The ECJ ruled that Polish limitation of the right to an income tax reduction for foreign health insurance contributions is a restriction on the freedom of movement and residence, which is not objectively justified.

In its judgment of 7 November 2007 (K 18/06), the Polish Constitutional Court stated that Article 27b of Polish law of 26 July 1991 on income tax payable by individuals did not comply with Article 32, read in conjunction with Article 2, of the Polish Constitution, inasmuch as it denies a possibility of deducting health insurance contributions from the income tax due on an activity performed outside Poland, where those contributions had not been deducted from income in the Member State in which that activity was performed. As a result of that judgment, Article 27b(1) has not been in force since 30 November 2008.

-- Magdalena Zasiewska, Jakub Zak and Agata Oktawiec, Poland; camiel.van.der.meij@pl.pwc.com

Portugal – ECJ referral on discriminatory Portuguese taxation of lottery winnings

On 14 April 2009, the European Commission announced that it decided to refer Portugal to the ECJ because of its discriminatory taxation of lottery winnings.

As reported in EUDTG Tax News 2008 – nr. 006, on 18 September 2008, the European Commission sent Portugal a formal request to amend its legislation which provides for the taxation of foreign lottery winnings whereas winnings from lotteries (*Euromilhões e Liga dos Milhões*) organised in Portugal by the *Santa Casa da Misericórdia de Lisboa* are not subject to taxation.

In response to the Commission's request, the Portuguese Government has changed the Personal Income Tax Code according to which winnings derived from lottery *Euromilhões* organised outside Portugal are no longer subject to taxation in Portugal (please refer to EUDTG Tax News 2009 – nr. 001). According to the legislation actually in force, only winnings derived from *Euromilhões* (whether organized in Portugal or in another country) are tax exempt.

Despite that change, the Commission still considers discriminatory the fact that other foreign lottery winnings that are not part of the *Euromilhões* lottery network continue to be taxed in Portugal.

Accordingly, the Commission considers that this exemption violates the EC Treaty and the EEA Agreement as it restricts the freedom to provide services and that this kind of difference in treatment cannot be justified as a measure to avoid the damaging consequences of gambling. The Commission's case reference number is 2007/2138.

-- Leendert Verschoor and Jorge Figueiredo; Portugal; jorge.figueiredo@pt.pwc.com

Spain – ECJ referral on restrictive Spanish exit tax provisions for individuals

On 19 March 2009, the European Commission decided to refer Spain to the ECJ on grounds of a breach of the right to free movement of persons.

Under Spanish law, where an individual transfers his residence abroad, he/she should include any unallocated income (i.e. income pending to be taxed) in his tax return for the last tax year in which he/she is still considered a resident taxpayer and will be taxed on such income

immediately. This is not in line with the general rule which sets forth that income should be taxed in the calendar year in which it is received.

In this context, on 16 October 2008 the Commission formally requested Spain to change its tax provisions which impose an exit tax on individuals who cease to be tax resident in Spain. Following the procedure established in article 226 of the EC Treaty, the request took the form of a reasoned opinion. Under this procedure, if there is no satisfactory reaction to the reasoned opinion within two months, the Commission may decide to refer the matter to the ECJ. The two months deadline expired and given that the Spanish tax rules were not amended to comply with the reasoned opinion, the Commission decided to refer Spain to the ECJ.

The Commission holds that the abovementioned Spanish regime is likely to dissuade individuals from exercising their right of free movement since such immediate taxation penalises those individuals who decide to leave Spain by introducing less favourable treatment for them as compared to those who remain in Spain.

The EC based its reasoning on the judgment of the ECJ in De *Lasteyrie du Saillant* (C-9/02). In this case, the Court held that the EC Treaty precludes national legislations from applying rules affecting taxpayers who transfer their tax residence to another Member State, for the immediate taxation of capital gains which have not been realised yet.

-- José Blasi, Rámon Mullerat and Rui Nascimento, Spain; jose.blasi@es.landwellglobal.com

Spain – AG opinion on Spanish capital duty rules: Commission v Spain (C-397/07)

On 5 March 2009, AG Kokott concluded that the Spanish Capital Duty legislation is not compatible with the EU Capital Duty Directive.

The European Commission had brought an action against Spain alleging that Spain has failed to fulfil its obligations under Directive 69/335/EEC, concerning indirect taxes on the raising of capital, by:

- Subjecting the application of mandatory exemptions from capital duty to additional conditions: the restructuring transactions (mergers, divisions, transfers of business activity) are exempt from capital duty provided that the special regime for reorganizations, regulated by the Spanish Corporate Income Tax act, is applicable and notified to the Ministry of Finance;

- Imposing an indirect tax on the transfer of the effective centre of management or the registered office of a company to Spain, for those companies which have not been subject to a similar tax in their country of origin;

- Subjecting to an indirect tax the capital used to finance Spanish branches or permanent establishments of companies that are resident in another EU state which does not apply a tax similar to the Spanish Tax.

The AG agreed with the Commission that the two first rules of the Spanish legislation (version in force until 31 December 2008) are incompatible with Directive 69/335/EEC. Regarding the third argument, the AG considers that the Commission has not proved sufficiently that Spain has failed to fulfil the requirements laid down in the Directive.

If the ECJ agrees with the AG's opinion and the future judgement had retroactive effects, the following companies would benefit (for operations carried out until 31 December 2008):

- Companies under tax audits where any of these subjects are being challenged (specially capital duty in restructuring transactions);

- Companies that have executed any of these transactions (restructuring transactions, transfer of the registered office to Spain, setting up permanent establishments) in periods covered by the statute of limitations, and

- Permanent establishments set up in Spain by EU entities.

-- Rámon Mullerat, José Blasi and Rui Nascemento, Spain; jose.blasi@es.landwellglobal.com

United Kingdom – AG opinion on lawfulness of UK stamp tax regime for entry into clearance service: HSBC Holdings Plc and Vidacos Nominees Ltd v HM Revenue and Customs case (C-569/07)

This case was referred by the UK Special Commissioners to the ECJ in December 2007 for a preliminary ruling in relation to the compatibility of the UK's 1.5% Stamp Duty Reserve Tax (SDRT) regime for clearance services with EC law.

By way of background, on acquiring the French bank CCF in June 2000, HSBC Holdings plc issued consideration shares to former CCF shareholders. Since many of these shareholders were French institutions and individuals, HSBC obtained a secondary listing on the Paris stock exchange and issued the consideration shares into Sicovam, the local clearance service, to facilitate local settlement. In so doing, HSBC was obliged to pay the 1.5% SDRT charge - totalling around £27m - in respect of these shares. HSBC challenged the legality under EC law of such a charge.

In his opinion dated 18 March 2009 AG Mengozzi found that the 1.5% SDRT charge levied by the UK upon the issuance of new securities into a clearance service and upon the transfer of existing securities into a clearance service is contrary to EU law. Given the very strong nature of the opinion, we believe it is likely that the ECJ will rule - in accordance with the AG's opinion - that SDRT previously charged in this context would have been charged contrary to EU law.

This offers an opportunity to reclaim the 1.5% SDRT paid on issues of new securities and on transfer of existing securities to clearance services. Furthermore, although not addressed in this case, we believe it may also be possible to reclaim the 1.5% SDRT paid on issues of new, or transfers of existing, UK securities to depositary receipt systems (typically American Depositary Receipts) and the 1.5% Stamp Duty paid on issues of UK bearer shares.

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NATIONAL DEVELOPMENTS

Belgium – Court of Appeal of Brussels judgment on abnormal and gratuitous benefits

On 29 October 2008, the Court of Appeal of Brussels rendered a decision regarding the compatibility of a Belgian anti-abuse provision dealing with abnormal and gratuitous benefits (hereafter "AGB") granted by a Belgian resident company with the basic EU principles of freedom of establishment and free movement of capital (case published on 4 May 2009).

From a Belgian tax perspective, an AGB occurs when a transaction does not take place at market conditions (i.e. does not comply with the "arm's length principle"). The "benefit" notion relates to enrichment without any compensation. The benefit is "abnormal" when it is contrary to usual habits, whereas it is "gratuitous" when it does not give rise to a duty or has been granted without any compensation.

According to Article 26 of the Belgian Income Tax Code (hereafter "BITC") applicable at the time of the facts, AGB granted by a Belgian resident company to a related company are added back to its taxable basis unless it can be demonstrated that these AGB are already included in the taxable basis of the beneficiary. In addition, the second paragraph of this provision mentions amongst others that irrespective of the foregoing, the advantages should always be added back to the taxable basis of the grantor if the beneficiary is a foreign tax resident with whom the Belgian corporation is directly or indirectly in a relationship of interdependence.

In the case at hand, the Belgian Tax Authorities considered that a Belgian resident company had granted an AGB to a related foreign tax resident and, based on article 26 of the BITC, included this benefit in the taxable basis of the Belgian resident company.

The case was brought before the Court of Appeal of Brussels, where the Belgian resident company argued that Article 26 of the BITC was contrary to the basic EU principles of freedom of establishment and free movement of capital to the extent that the taxation of an AGB in the hands of the company granting the AGB depends on the tax residence of the beneficiary of such AGB i.e. Belgian resident company or foreign tax resident company.

In its judgement of 29 October 2009, the Belgian Court of Appeal considered that Article 26 of the BITC does not infringe EU tax law. According to the court's view the given anti-abuse provision does not apply when, as a rule, the collection of the tax due on the AGB is possible, which is the case when the AGB are included in the (Belgian) taxable basis of the recipient. In case an AGB is granted to a foreign company, whether European or not, Article 26 therefore only aims to collect (Belgian) tax on the amount that should have been included in case the arm's length principle would have been complied with.

Recently, the compatibility of this Belgian anti-abuse provision with EU law has already been referred to the ECJ following a preliminary ruling of the Court of First Instance of Mons on 14 July 2008 (Société de Gestion Industrielle, Case C-311/08; cfr bi-monthly newsletter nr 006, September-October 2008). According to our information, the latter case will be heard on 4 June 2009.

In this respect, it may be interesting to see whether the ECJ will make a link with its position in the *Oy AA Case* (C-231/05, 18 July 2007), in which it considered that, taking into account the need to ensure fiscal coherence, by the allocation of taxation powers between the Member States and the need to prevent tax avoidance, the EU freedoms do not preclude a system whereby a subsidiary resident in a Member State may not deduct an intra-group financial transfer which it makes in favour of its parent company from its taxable income unless that parent company has its establishment in that same Member State.

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

Finland – Central Tax Board judgment on transfer of carry-forward tax losses in connection with a cross-border merger

The Finnish Central Tax Board ("CTB") issued on 25 March 2009 an advance ruling (KVL 17/2009) in which it denied transfer of tax losses of a Swedish limited liability company ("A AB") into its Finnish parent company in case of a cross-border merger.

B Oy had held all of the shares of A AB for a period of approx. ten years. A AB had wound up its non-profitable business activities in 2008 and had unutilized carry-forward tax losses from several tax years. After the merger, there was no permanent establishment of B Oy in Sweden.

The Finnish Income Tax Act ("ITA") regulates the impact of a merger to the right to deduct carry-forward tax losses. According to ITA, the receiving company has the right to deduct the carry-forward tax losses of the merging company if certain ownership requirements are fulfilled. According to the CTB, the provisions of the ITA did not allow the transfer of A AB's losses to B Oy in the cross-border merger. This was because the losses of A AB were not calculated in accordance with the provisions of Finnish tax law and, therefore, were not losses within the meaning of the ITA. The CTB did not consider the ITA provisions in question to be in breach of EC law.

The outcome of the decision has been built on quite formal grounds and could as such be considered to be contrary to the freedom of establishment articles of the EC Treaty and more specifically the ECJ's decision in C-446/03, *Marks & Spencer*, where the ECJ stated that final losses which cannot be utilized in the residence state of the subsidiary should be taken into account in the country of the parent company.

The CTB's advance ruling is not yet legally binding and appeal to the Finnish Administrative Court has been made.

-- Jarno Laaksonen and Heidi Katajainen, Finland; jarno.laaksonen@fi.pwc.com / heidi.katajainen@fi.pwc.com

Germany - Case pending with the Federal Tax Court on exit tax upon relocation of German inventor to Belgium

A German resident individual (claimant) derived income from professional services as an inventor in Germany. In 1995, he moved to Belgium without changing the nature or way of conducting his business. The tax authorities nonetheless viewed his migration as a termination of his professional enterprise in Germany and thus increased his taxable income in the amount of about EUR 180,000.

According to German case law, the relocation of a business to another country is regarded as a realisation event insofar as unrealised capital gains in the business can no longer be taxed. Upon migration, the business is thus deemed to have been terminated and capital gains in the business are taxed accordingly. Applying these rules to income from professional services, in the present case the tax authorities argued that the relocation to Belgium led to a tax on unrealised capital gains in the inventor's enterprise.

The Tax Court of Cologne, to which the claimant appealed, considered in its decision on 18 March 2008 the immediate taxation upon migration of the inventor's business as an infringement of the freedom of establishment as relocation within Germany would not have been regarded as a termination of the enterprise. As in a similar decision by the Tax Court of Rheinland-Pfalz (see our Newsletter 2008-003), the Court referred to the ECJ judgments in *De Lasteyrie du Saillant* (C-9/02) and *N* (C-470/04) stating that immediate taxation of unrealised capital gains infringes the freedom of establishment. Accordingly, the rules established by the German Federal Tax Court under which the migration of the business to another Member State must be regarded as the termination of that business, i.e. a realisation event, were found by the Court not to be applicable. Also, the Court did not find any justifications to be at hand, especially as the rule would not provide for less restrictive measures.

Due to the importance of the legal questions, the case was admitted to the Federal Tax Court, where it is now pending.

-- Raimund Behnes and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Germany - Federal Fiscal Court judgment on taxation of construction services

According to German tax law, a withholding tax of 15% is levied on any construction services. This tax has to be paid by the recipient of the construction service on behalf of the service provider. In case the tax debt has not been fully paid, the recipient of the construction service is liable for the tax debt of the service provider. The provider of construction services can apply for a certificate of exemption. In contrast to resident service providers, non-resident service providers are obliged to hand in a certificate of residence from their country of residence, as well as provide for an authorised receiving agent resident in Germany in order to be granted a certificate of exemption.

In the case at hand, the plaintiff, a German recipient of construction services, was held liable for the tax debts of a foreign construction service provider, who used a fake certificate in order

to be granted an exemption from German withholding tax. The plaintiff appealed against the tax assessment notice based on the incompatibility of these provisions with EC Law.

The German Federal Fiscal Court (BFH) in its resolution from 29 October 2008 only decided on the suspension of execution of the tax assessment notice. The matter itself is still pending. The suspension of execution has to be granted when the tax assessment could seriously be doubted lawful. As the decision about the suspension only deals with the question whether these doubts are serious ones or not (and not with the matter itself) the BFH is not obliged to refer to the ECJ. Nevertheless, this interim ruling reflects the actual attitude of the BFH regarding the compliance of German withholding tax with EC Law (see Newsletter 1/2008).

Since the court did not find serious doubts it rejected the plaintiff's demand. The court begins its reasoning by drawing a comparison between the mechanisms of withholding taxation for construction services on the one hand and for foreign artists and athletes on the other hand. Stating that both mechanisms are systematically comparable, the court applies its former decision regarding the taxation of artists and athletes also to the taxation of construction services and reconfirms the compatibility of the mechanism with EC Law (see Newsletter 1/2008).

Secondly, the court points out that the regulations over the taxation of construction service providers at no point tie up to the nationality of the service provider, and therefore do not discriminate against foreign service providers.

Thirdly, the court picks up the discussion regarding a potential discrimination against non-resident service providers on the grounds of the above mentioned higher requirements (certificate of residence, receiving agent) in order to be exempted from withholding taxation in Germany. In this context, the court emphasises that the discriminatory treatment of non-resident construction service providers is less incisive compared to non-resident artists and athletes and therefore also does not give reason for serious doubt about the provision's compatibility with EC Law.

-- Stefan Ickenroth and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Germany - Taxation of investment funds and application of Art 57 Para. 1 EC

On 16 December 2008, the Finance Court Munich handed down its judgement on the former German law on the taxation of foreign investment funds. According to former legislation, both German and foreign investment funds had to fulfil special requirements in order to be treated as transparent entities for German tax purposes.

In the case at hand, a fund with its statutory seat in the US did not meet those requirements. As part of the special provisions concerning the taxation of foreign investment funds, the investor's income was calculated on a lump-sum basis, involving the market value of the participation in the investment company (deemed profits). Moreover, the investor did not have any possibility to demonstrate the actual profits. As such lump-sum taxation would not have been applicable in case of a domestic investment fund (here: taxation on actual profits), the

court was asked to decide whether such different treatment depending on the seat of the fund was compatible with the free movement of capital.

In its decision the court did not see a necessity to check the compatibility of the provision at issue with the free movement of capital, arguing that the following two conditions of the so called stand still clause of Art 57 Para. 1 EC were met:

At first, the court confirms the opinion of the German Federal Finance Court, stating that the activities of the respective investment fund falls under the scope of the provision of financial services as mentioned in Art. 57 Para. 1 EC.

Secondly, the court also confirmed the existence of the restrictive provision before the crucial date of 31 December 1993. Although this provision has been changed in 2001, the court rejected the disapplication of Art. 57 Para. 1 EC, stating that equal to the situation previous to the amendment, deemed profits of a foreign investment fund were fully taxable at the level of the investor. Therefore the effect of the provision has not tightened compared to year 1993.

As both requirements of the stand still clause were met, the free movement of capital is not applicable. The claimant filed an appeal against this decision at the Federal Finance Court.

-- Stefan Ickenroth and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Germany: Case pending with the Federal Finance Court on withholding taxes for non-resident artists

On 15 October 2008, the Finance Court of Hamburg decided in two similar cases that the withholding tax for non-resident artists is in line with EC law. The existence of the recovery directive 2001/44/EC would not lead to another conclusion.

The claimants, two German resident agencies, hired foreign artists in 1996, 1997, 1998 and 2001. According to German tax law, the agencies had to withhold taxes on the payments after deducting directly linked business expenses which were reported to them. As the amount of withheld taxes was not correct, the tax authorities assessed notices of liability against the agencies in 2001. The agencies objected against these notices, arguing that the mechanism of withholding tax itself was incompatible with EC law.

The Finance Court of Hamburg rejected the claims. At first, the court stated that the hint of the ECJ in the *Scorpio* case (C-290/04) in par. 37 could not be interpreted in the way that the mere existence of the recovery directive leads automatically to a breach of the freedom to provide services if taxes are withhold. In the court´s view, the ECJ had not answered this question yet. The court argued that, when checking the compatibility with EC law, only the situation in the year when the tax is due had to be considered. The year in which the liability notice was assessed should not be decisive. In the cases at hand, the tax was due in the years 1996, 1997, 1998 and 2001 when the recovery directive had not been in force yet and therefore it had not to be considered. Although the court acknowledged that the recovery directive as a mean of procedural law was applicable to all open cases, so also to the cases at hand, it rejected its impact on the mechanism of withholding taxes, as this mechanism was

not a procedural one. On the contrary, the withholding of taxes should be interpreted as a rule that creates the liability of taxes of the debtor of fees (agency). Moreover, due that the fact that the cross-border recovery of taxes had actually not been conducted successfully in the past years, the court drew the conclusion that the mechanism of withholding taxes was still crucial to collect taxes.

The claimants appealed against these decisions on a point of law. These cases are now pending with the Federal Finance Court.

-- Gitta Jorewitz and Juergen Luedicke, Germany; juergen.luedicke@de.pwc.com

Italy – Regional Tax Court in Rome judgment on Italian CFC rules

The Regional Tax Court in Rome ("*Commissione Tributaria Regionale di Roma*" – second degree judge) recently issued a decision in a case concerning the application of the Italian tax legislation on CFC.

The Italian CFC rules in force, laid down in sections 167-168 of the Italian Tax Code, provide that in case an Italian stockholder, directly or indirectly, holds a controlling participation (or a participation higher than 20% in the profits) in a company resident for tax purposes in a low-tax jurisdiction (included in a "black list" approved by a 2001 Ministerial Decree), the profits of the latter are taxed in the hands of the Italian stockholder in proportion to the participation held and irrespective of dividend distributions at the average taxrate applied on its whole income (minimum taxrate: 27%). However, the Italian stockholder can disapply, by means of a ruling submitted to the competent Italian tax authorities such rules, alternatively proving that:

- the CFC carries out an active trade or business as its main activity in the low-tax jurisdiction; or
- the participation in the CFC does not have the effect of locating profits in a low-tax jurisdiction.

The case at hand involved an Italian tax resident company which held a participation of control in a CFC resident for tax purposes in Cyprus (i.e. a country included in the above-mentioned black list). In order not to apply the Italian CFC rules, it had submitted a ruling request to the Italian Tax Authorities. The ruling was rejected because neither of the two exceptions were proved in the case at hand.

The appeal against that decision was rejected by the Provincial Tax Court in Rome ("*Commissione Tributaria Provinciale di Roma"* - first degree judge). Therefore, the company also appealed the negative decision of the first degree judge to the Regional Tax Court. At this stage, the appellant requested the non-application of the CFC rules also based on the opinion that such rules are in breach of EC Law. The appellant also asked for a preliminary ruling to the ECJ in case the Italian judge had some doubts on the compatibility of such rules with EC Law.

The Regional Tax Court rejected the appeal also declaring that the Italian CFC rules are not in breach of the EC Law and, in particular, of the freedom of establishment (Art. 43 EC). According to the court, such tax rules do not restrict the setting up of subsidiaries in other EU Member States, as such rules only aim at combatting abusive practices. The court supported its decision by declaring that almost all the Member State have a CFC legislation similar to the Italian one.

It is quite interesting to note that the Regional Tax Court rejected the reason submitted by the appellant without beforehand making an in-depth analysis of the CFC legislation in the light of the EC Law. In addition, they did not justify their decision not to suspend the proceedings in order to request a preliminary ruling to ECJ (as requested by the appellant).

It is highly surprising that the court reached the above-mentioned conclusion with reference to the compatibility of the Italian CFC legislation with EC Law without taking into account that CFC rules can be applied within the Community area only in the case of "wholly artificial arrangements", based on the principles expressed by the ECJ on CFC (in particular in the *Cadbury Schweppes* case, C-196/04) and on the 2007 Communication of the European Commission on the application of anti-abuse rules in the field of direct taxation within the EU.

On the basis of the information available, as the Cyprus company seems to be an effective company and may not be considered a "wholly artificial arrangement", CFC rules should have been disapplied in the case at hand in order not to constitute an unjustified restriction to the freedom of establishment protected by article 43 EC.

For completeness, it has to be pointed out that the Italian legislation on CFC has been amended by the 2008 Financial Law with the substitution of the current black list with a white list. The latter has not been approved yet and so far the previous CFC rules described above are still applicable. For more information on the new Italian CFC legislation, please see also EUDTG Newsletter Issue 2008 - nr. 001

-- Claudio Valz and Giovanna Lembo, Italy; claudio.valz@it.pwc.com

Portugal - Supplementary State Budget for 2009

The supplementary State Budget for 2009, referred in the EUDTG Tax News 2009 – nr. 002, that foresees the extension of the special tax regime applicable to Portuguese holding companies (SGPS, *Sociedade Gestora de Participações Sociais*), incorporated under the Portuguese law (Tax Benefits Code, *Estatuto dos Benefícios Fiscais* – article 32), to companies incorporated under the law of another EU Member State, whose head office or place of effective management is located in Portugal, was approved by the Parliament and published on the Official Gazette Number 48 of 10 March 2009.

According to the law now in force, EU companies will benefit from the special tax regime, previously applicable only to SGPS companies incorporated under the Portuguese law, provided that they meet the requirements to which this type of holding companies are subject to, as foreseen in Decree-Law number 495/88 of 30 December 1988.

The main benefits from this special regime are the following: (i) Elimination of double economic taxation on dividends received; (ii) Exemption from taxation of capital gains realized on the transfer of shares held for at least 1 year, if certain requirements are met; and (iii) Financing costs (interest) incurred in the acquisition of the referred shares are not deductible.

-- Leendert Verschoor and Jorge Figueiredo; Portugal; jorge.figueiredo@pt.pwc.com

Spain - Spanish High Court judgment on capital gains from real estate

On 3 March 2009, the High Court of Justice of the Valencian Autonomous Community ruled on the difference in the tax treatment of resident and non-resident EU taxpayers as regards the taxation of gains realised on the sale of real estate (up to 31 December 2006).

In 2004, two British nationals – both non-resident in Spain - sold a house located in the Spanish territory after one year of possession. This gave rise to a capital gain. Under the Spanish Non-residents Income Tax Act in force at the time (Royal Decree 4/2004, dated 5 March), the capital gain was considered as having been obtained in Spain and was therefore taxed at a flat rate of 35%. The application of Spanish Tax Law resulted in a different treatment between residents and EU non-residents, since in an objectively similar situation Spanish residents would have been subject to a fixed rate of 15%.

On these grounds, the British nationals challenged the Spanish rule. Their claim was rejected both by the competent Spanish Tax Office and by the Regional Administrative Court of Valencia.

However, in January 2009 the British nationals gave notice of an appeal before the High Court of Justice of the Valencian Community. Said appeal was supported by the formal request sent on July 2005 by the European Commission to Spain to amend its discriminatory legislation concerning the taxation of EU non-residents on capital gains realised on the sale of Spanish real estate. The Commission considered that the difference in the tax treatment of the two categories of taxpayer - in so far as it results in a higher tax burden on EU non-resident individuals in situations objectively similar to residents - constitutes indirect discrimination on the grounds of nationality prohibited by the EC Treaty.

In line with the request of the Commission, the Spanish Non-residents Income Tax Act was amended by Law 35/2006, in force since 1 January 2007. The new version sets forth that gains obtained by non-residents from the sale of real estate shall be taxed at a rate of 18%. The Individuals Income Tax Act applicable to residents in Spain sets forth that gains should also be taxed at a flat rate of 18%. Therefore, from 1 January 2007, residents and non-resident individuals are no longer treated differently on the taxation of capital gains realized from real estate located in Spain.

The High Court of Justice of the Valencian Community, in line with various judgments of the ECJ, recognised that the relevant provisions of the Spanish Non-residents Income Tax in force until 31 December 2006 were contrary to EC Law. Accordingly, it held that the British nationals were entitled to the refund of the amount withheld in excess plus interest on delay payment.

This decision should open the door for non-residents to claim back unenforceable taxes on capital gains from real estate under similar circumstances.

-- Rámon Mullerat, José Blasi and Rui Nascemento, Spain; jose.blasi@es.landwellglobal.com

Spanish Government announcement to amend the Non-residents Income Tax Act (Pension Funds and rules for determining the taxable base)

On 30 April 2009, the Spanish Ministry of Economy and Finance announced in a press release it will introduce amendments to the Spanish Non-residents Income Tax Act in order to end the discriminatory treatment of non-resident EU (and EEA) based pension funds, and that amongst other things, dividends and gains paid to non-resident pension funds will be exempt from taxation. In recent weeks, the Spanish media have speculated that the Government will amend its legislation before 2010.

The Spanish Government has now confirmed that the Bill that it intends to submit to the Spanish Parliament will seek to modify Spain's non-resident domestic tax rules that either directly or indirectly, potentially or effectively, impose a discriminatory treatment on non-resident pension funds, as this breaches the Fundamental Freedoms set forth under the EC Treaty.

The Bill which has not yet been made public will introduce the following amendments:

(a) Exemption of taxation (no withholding tax) on dividends distributed by Spanish entities to foreign EU Pension Funds or to permanent establishments of said Pension Funds located in another EU Member State. Basically, this measure aims at ending the discriminatory treatment imposed on EU based Pension Funds when compared to domestic ones.

(b) Modification of the rules currently in existence for calculating the taxable base of certain types of income obtained by non-residents that reside in the European Union without having a permanent establishment in Spain. Basically, this measure aims at taxing certain types of income (still to be determined) on a net basis as if they were tax residents in Spain rather than on a gross basis as is currently the case.

The Government announcement indicates an awareness that the current legislation may be in breach of the EC Treaty. This is a welcome new development, as the European Commission announced on 27 November 2008 that it had referred Spain to the European Court of Justice for its non-compliance with the EC's formal request to amend its legislation. The Commission's action was based on a joint complaint filed by PwC and EFRP with the Commission in 2005 against Spain and a number of other EU Member States.

Pension funds which have filed "protective" refund claims in a timely and correct manner should be affected positively by the prospective change of legislation. To safeguard their rights for previous years and for the future, EU pension funds should consider filing protective refund requests in line with local statutory time limits.

-- Rámon Mullerat, José Blasi and Rui Nascemento, Spain; jose.blasi@es.landwellglobal.com

Sweden - Swedish group relief system is not in line with the freedom of establishment, says Swedish Supreme Administrative Court

The Swedish group relief system (Sw. *"koncernbidrag"*, group contribution) allows a qualifying company to take a tax deduction for a transfer of funds to another Swedish company, provided that this other company reports the funds received as taxable income. Typically, this other company has incurred a loss, and so the tax consolidation effect is achieved. The Swedish legislation stipulates that the group contribution is not tax deductible in case the recipient is not liable to tax in Sweden.

It has been debated in Sweden for years if the Swedish rules are in line with the freedom of establishment in the EC Treaty. The ECJ judgments in *Marks & Spencer* (C-446/03) and *Oy AA* (C-231/05) added to this debate. The Swedish Government and the Swedish tax agency stated that they found it clear that the Swedish group contribution system did not have to be amended in any way. The Swedish Advance Tax Ruling Board did not share this view in several rulings in 2006, 2007 and 2008. The rulings were appealed to the Swedish Supreme Administrative Court ("the Court").

The Swedish Administrative Court finally handed down 10 unanimous judgments on this matter on 11 March 2009. It is clear that the Court disagrees with the views taken by the Government and the tax agency. The Court also found it unnecessary to ask the ECJ for a preliminary ruling.

In line with *Marks & Spencer*, the court ruled that a Swedish parent company will get 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. The court noted that a Swedish parent company would have been able to deduct a group contribution to a Swedish subisidiary the year before the liquidation of the Swedish subsidiary is finalized. The same should apply to a group contribution to a subsidiary within the EEA area. The court also gave some guidelines on the complex issue of how the amount of the tax deductible group contribution should be calculated. Still, some uncertainties remain to be clarified.

In line with the Oy AA case, the court on the other hand also ruled that a group contribution from a Swedish subsidiary to its parent company within the EEA will not be tax deductible in Sweden. A few cases involving group contributions from a Swedish sister company to another sister company within the EEA were furthermore rejected, and a few cases concerning merger losses were dismissed.

In a comment the day after the Court's judgments had become public, the Swedish Finance Minister stated that he will study the judgments very carefully. He added that it could not be ruled out that actions will be taken to protect the Swedish tax base.

-- Fredrik Ohlsson and Gunnar Andersson, Sweden; gunnar.andersson@se.pwc.com

Sweden - Swedish Supreme Tax Court judgment on deductibility of foreign exchange losses on debts in foreign currencies

In 1992, the taxpayer obtained a loan denominated in DEM. When Germany later changed its currency to EUR in 2001 it was replaced with a Euro loan. Following the rate change between 1992 and 2001 a f/x loss occurred – which according to Swedish tax provisions is only deductible at 70% (this rule applies to most losses from capital sources).

The taxpayer argued that this restriction is not in line with EC law as there is no similar negative restriction when it comes to debts in SEK. The tax authority and the lower tax courts did not however find the restriction discriminating, as there was no proper comparative situation at hand and furthermore, f/x losses on SEK debts cannot even arise.

The Supreme Tax Court, however, found the restriction deductibility contrary to Community law and concluded that such a restriction could increase the financial risk of taking up a loan in foreign currency, which may discourage borrowers from obtaining loans in foreign currency. The fact that the Swedish provisions on capital losses also in general only allow deductions at 70%, does not make the restriction acceptable from an EC law perspective. Therefore, a full deduction for the f/x loss was allowed (with reference to ECJ case C-293/06 *Deutsche Shell* and Article 56 EC).

This decision seems to support the view that currency losses on participations in EU/EEA subsidiaries should be deductible at the level of the parent company.

-- Gunnar Andersson, Sweden; gunnar.andersson@se.pwc.com

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EU DEVELOPMENTS

EU - European Commission proposes actions to improve transparency, exchange of information and fair tax competition

On 28 April 2009, the European Commission adopted a Communication identifying how "good governance" in tax matters may be improved within the EU and at international level. The document builds on the recent G20 conclusions concerning “uncooperative tax jurisdictions” or tax havens and bank secrecy. The Commission asserts that due to the financial and economic crisis, national budgets and tax systems are increasingly under threat and that there is a strong need for more international cooperation and common standards to fight tax fraud and avoidance based on the following principles: transparency, exchange of information and fair tax competition. For the full text of the Communication (COM/2009/201).

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

EU - European Commission issues update report on functioning of Interest and Royalties Directive

On 17 April 2009, the European Commission announced that it has sent an update report to the Council on the implementation and operation of the Interest and Royalties Directive EU-wide. The aim of the Directive is to eliminate double taxation on cross-border interest and royalty payments between associated companies. Discussions on the findings of the report at Council level should provide guidance to the Commission for a future amending legislative proposal. Click here for the full text of the report.

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

EU - European Commission adopts two proposals for new Directives aimed at improving mutual assistance between Member States' tax authorities in the assessment and the recovery of taxes

On 2 February 2009, the European Commission adopted two proposals for new Directives aimed at improving mutual assistance and cooperation between EU Member States' tax authorities in the assessment and the recovery of taxes. The proposals (COM/2009/28 and COM/2009/29) are part of the Commission's "fight against tax fraud" and cover:

Administrative cooperation regarding the assessment of taxes:

- Common rules of procedures, common forms, formats and channels for exchanging information. It also allows tax administration officials in one Member State to be on the territory of another Member State and to participate actively – with the same powers of inspection - in administrative enquiries carried out there;
- Requested Member State cannot refuse to supply information concerning a taxpayer of the requesting Member State solely because this information is held by a bank or other financial institution. The proposal abolishes bank secrecy in the relations between tax authorities when a requesting Member State is assessing the tax situation of one of its resident taxpayers.

Administrative cooperation regarding the recovery of tax claims:

- Covers all taxes and duties levied by the Member States and their administrative subdivisions, as well as compulsory social security contributions;
- Introduces compulsory spontaneous exchange of information concerning refunds of taxes made by national tax authorities to non residents;
- Allows officials of one country to actively participate in administrative enquiries on the territory of another country;
- Allows that recovery assistance is requested in an early stage of the recovery process, if this leads to an increase of the recovery chances;
- Simplifies and rationalises the procedures to be used when requesting or providing mutual assistance.

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

Austria – European Commission formally requested Austria to end the discriminatory tax treatment of donations regarding science, research and adult education.

According to the Austrian Income Tax Act donations on science and research are only tax deductible at the level of the spending company/individual (however limited to 10% of the tax profit of the donating company/individual of the previous year) if:

- the donations are contributed to certain public Austrian institutions defined by law (e.g. universities, art colleges, academy of science, etc.) or
- the donations are dispensed to non-profit organisations carrying out research and educational activities mainly for the benefit of the Austrian science or economy.

The European Commission is of the opinion that the restriction on the tax deductibility of donations in the field of scientific research and adult education as defined under Austrian tax law is not in line with the principle of free movement of capital (Article 56 of the EC Treaty and Article 40 of the EEA Agreement) since this beneficial treatment does not apply for donations granted to comparable institutions located outside Austria.

Moreover, according to the Commission the restriction that donations are only tax deductible provided they are granted to non-profit entities carrying out research and ecucational activities for the benefit of the Austrian science or economy is - for the same reason as outlined above - not in line with the principle of freedom of services and the principle of free movement of capital (Article 49/56 of the EC Treaty and Article 36/40 of the EEA Agreement).

If no satisfactory reaction is provided by the Austrian government to the European Commission within two months, the Commission may decide to refer this issue to the ECJ.

-- Rudolf Krickl and Richard Jerabek, Austria; friedrich.roedler@at.pwc.com

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STATE AID

Italy – European Court of First Instance: Italian regime for investment vehicles specialised in small- and mid-caps constitutes State aid

On 4 March 2009, the Court of First Instance handed down two similar judgments concerning the Italian regime for certain investment vehicles specialised in shares of small- and medium-capitalisation companies listed on a regulated market of the European Union (hereinafter: small- and mid-caps).

Under the general Italian system of taxation on collective investment funds, an investment vehicle is ordinarily subject to a 12.5% substitute tax on its net operating result. However, investment vehicles investing at least two thirds of the value of their assets in shares of small- and mid-caps are subject to a 5% substitute tax, instead of the "ordinary" substitute tax. This tax scheme amends the tax rules applicable to all the various investment vehicles operating in

Italy (i.e. open-ended investment funds, historic Luxembourg funds, closed-end investment funds, SICAVs, pension funds).

The Commission decided to initiate the formal investigation procedure laid down in Article 88(2) of the EC Treaty in respect of this tax measure. On 6 September 2006 the Commission issued its decision declaring that the present scheme constitutes a State aid incompatible with the common market.

According to the Commission:

1. the investment vehicles with corporate form and the undertakings managing vehicles without legal personality are undertakings within the meaning of the State aid concept of the EC Treaty;
2. the more favourable tax treatment grants a selective tax advantage to both certain small- and mid-caps, consisting in the increased demand for their shares and in increased liquidity, and certain investment vehicles, as it provides with them additional liquidity and extra income in terms of entry and management fees;
3. the tax advantage in question is granted and financed by the State as it consists in foregone tax revenues;
4. the tax measure at hand may distort competition between undertakings and affect trade between Member States because the beneficiaries can operate in international markets and pursue commercial and other activities in markets where competition is intense.

In addition, as Italy failed to notify the tax scheme before its implementation, the Commission ordered the recovery of the unlawful aid from its beneficiaries.

The Court of First Instance rejected the appeals against the Commission's decision entirely. Appeals against the decisions by the Court of First Instance decisions may be lodged with the Court of Justice within two months of the notification of the decisions.

-- Claudio Valz, Italy; claudio.valz@it.pwc.com

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CCCTB

EU - Outlook for the CCCTB

Progress on a new proposal of the Commission for a Directive on CCCTB now seems highly unlikely in 2009 and even the first half of 2010. In the meantime, the Commission Services have relieved the Head of the Commission's CCCTB Task Force (Thomas Neale) who has not been replaced. The outgoing Commission will be reluctant to take any decisions that are controversial and which could stand in the way of any (re-)election bids of Commissioners or that it feels could be "better dealt with" by a new Commission with a fresh 5-year manadate.

The current Commission is however contemplating staying on beyond November 2009 - possibly for another 6 months as it is unsure whether the signing and ratification of the Lisbon Treaty can be done on time (before November 2009). The Irish people still need to vote in a second referendum on the Lisbon Treaty (the Yes vote is growing according to polls) which is now likely to be held in October 2009. Czech and Polish presidential ratification of the Lisbon Treaty is also still pending. This means that most of the politically sensitive dossiers will be postponed until the new Commission comes into office.

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

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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.

For further information regarding the contents of this newsletter or the EUDTG in general, please contact the EUDTG Secretariat through Bob van der Made (email: bob.van.der.made@nl.pwc.com; or tel.: + 31 10 407 5688).

EU Tax News editors: Peter Cussons, Bob van der Made and Irma van Scheijndel.

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EUDTG CONTACT LIST

Chairman:
Frank Engelen frank.engelen@nl.pwc.com

EUDTG Secretary:
Bob van der Made bob.van.der.made@nl.pwc.com

Country contacts:

Austria	Friedrich Roedler	friedrich.roedler@at.pwc.com
Belgium	Olivier Hermand	olivier.hermand@pwc.be
Bulgaria	Georgy Sarakostov	georgy.sarakostov@bg.pwc.com
Cyprus	Marios Andreou	marios.andreou@cy.pwc.com
Czech Rep.	Zenon Folwarczny	zenon.folwarczny@cz.pwc.com
Denmark	Soren Jesper Hansen	sjh@pwc.dk
Estonia	Erki Uustalu	erki.uustalu@ee.pwc.com
Finland	Karin Svennas	karin.svennas@fi.pwc.com
France	Jacques Taquet	jacques.taquet@fr.landwellglobal.com
Germany	Juergen Luedicke	juergen.luedicke@de.pwc.com
Greece	Alexandros Sakipis	alexandros.sakipis@gr.pwc.com
Hungary	Gabriella Erdos	gabriella.erdos@hu.pwc.com
Iceland	Fridgeir Sigurdsson	fridgeir.sigurdsson@is.pwc.com
Ireland	Anne Harvey	anne.harvey@ie.pwc.com
Italy	Claudio Valz	claudio.valz@it.pwc.com
Latvia	Zlata Elksnina	zlata.elksnina@lv.pwc.com
Lithuania	Kristina Bartuseviciene	kristina.bartuseviciene@lt.pwc.com
Luxembourg	Álina Macovei-Grencon	alina.macovei-grencon@lu.pwc.com
Malta	Kevin Valenzia	kevin.valenzia@mt.pwc.com
Netherlands	Frank Engelen	frank.engelen@nl.pwc.com
Norway	Aleksander Grydeland	aleksander.grydeland@no.pwc.com
Poland	Camiel van der Meij	camiel.van.der.meij@pl.pwc.com
Portugal	Jorge Figueiredo	jorge.figueiredo@pt.pwc.com
Romania	Mihaela Mitroi	mihaela.mitroi@ro.pwc.com
Slovakia	Todd Bradshaw	todd.bradshaw@sk.pwc.com
Slovenia	Janos Kelemen	janos.kelemen@si.pwc.com
Spain:	José Blasi	jose.blasi@es.landwellglobal.com
Sweden:	Gunnar Andersson	gunnar.andersson@se.pwc.com
Switzerland	Armin Marti	armin.marti@ch.pwc.com
UK	Peter Cussons	peter.cussons@uk.pwc.com

CCCTB central contact:
Peter Cussons peter.cussons@uk.pwc.com

EU State aid central contact:
Pieter van der Vegt pieter.van.der.vegt@nl.pwc.com