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Recent EU Tax Developments

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Recent EU Tax Developments

Issues

• EU Enlargement
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On May 1, 2004 10 new Member States joined the EU:

- Cyprus
- Czech Republic
- Estonia
- Hungary
- Latvia
- Lithuania
- Malta
- Poland
- Slovakia
- Slovenia
Recent EU Tax Developments

EU Enlargement

Several other countries are in the process of acceding the EU:

- **Bulgaria and Romania** - are Acceding Countries, expected to become EU Member States on January 1, 2007 if certain conditions are met. On April 13, 2005 the European Parliament gave its assent to the Accession Treaty, and the Treaty was signed with both countries - April 25, 2005.

- **Turkey, Croatia and Macedonia** - are Candidate Countries. Accession negotiations have started with Turkey and Croatia - October 2005. The European Council granted the former Yugoslav Republic of Macedonia the status of a candidate country in December 2005.

- **Potential Candidates** - The EU also defined Albania, Bosnia and Herzegovina and Serbia and Montenegro as Potential Candidate Countries.
Member states prior May 1, 2004:
- Austria
- Belgium
- Denmark
- Finland
- France
- Germany
- Greece
- Ireland
- Italy
- Luxembourg
- The Netherlands
- Portugal
- Spain
- Sweden
- United Kingdom

Applicant Members:
- Bulgaria
- Romania
- Turkey
- Croatia
- Macedonia

Member states as of May 1, 2004:
- Cyprus
- Czech Republic
- Estonia
- Hungary
- Latvia
- Lithuania
- Malta
- Poland
- Slovakia
- Slovenia
EU Tax Policy

**EU Tax decisions**
- Veto principle remains – unanimity required for EU decisions in the area of taxation, i.e., no qualified majority voting (QMV) (Article 94 EC Treaty).

**Tax Competition**
- Since there is no harmonization of direct taxes, tax competition exists in practice and does not contradict current EU law.
- Significant progress towards harmonization was achieved in the indirect taxes area.
EU Tax Policy

Indirect Taxes - EU Tax Harmonization

General

- The subject is under discussion and debate for many years (1960 - a Working Group was set to examine how to harmonize turnover taxes).
- Indirect and direct tax harmonization are separate areas.
- Customs duties and discriminating measures (trade barriers) on other Member States (“MS”) goods and services are incompatible with the EC Treaty.
- Therefore, indirect taxes harmonization is a Community basic goal.
- The EC Treaty provides legal grounds for indirect taxes harmonization:
  - Custom duties on products (Art. 90).
  - Indirect taxes harmonization, as long as necessary to ensure the establishment and function of one internal market (Art. 93).
- Turnover taxes have been harmonized on the basis of Article 93.
Recent EU Tax Developments

EU Tax Policy

Direct Taxes - Proposed Tax Harmonization Initiatives

• The effect of indirect taxes on the Common Market is “clearer” than of direct taxes.

• Yet, the effect of the domestic direct tax systems is more distortive (especially unequal tax treatment in different MS, double taxation, distortion of competition and certain existing barriers on free movement of capital).

• Following the May 2004 enlargement, the administrative burden is now significantly higher (i.e., 25 different tax systems).

• These differences invite tax planning, tax avoidance and tax evasion.

• In order to minimize these risks, further cooperation between MS was implemented, for example the Mutual Assistance Directive (Council Directive 77/779 EEC) and its amendments, in addition to cooperation on bilateral level, based on the OECD Model Convention.
EU Tax Policy

Direct Taxes - Proposed Tax Harmonization Initiatives

• Due to political reasons (mainly MS tax sovereignty) direct tax harmonization has no clear and solid legal base in the EC Treaty.

• Article 94 EC Treaty - provides only a general legal base for EC direct tax measures, as long as they are necessary for the functioning of the Common Market.

• The process must include Council unanimity and adoption of measures with the involvement of the Commission and the Parliament.

• Article 94 is envisaged as aiming to approximate mainly corporate income tax.
EU Tax Policy

Direct Taxes - Tax Harmonization Initiatives – EU level entities

- **European Economic Interest Grouping – EEIG**: This entity can be described as a partnership between persons on the EU level, in order to simplify business activities in more than one Member State. The rational is the pooling of resources, activities or skills in order to address certain business goal.

- **Societas Europea – SE**: Following the Commission's White Paper on completion of the internal market the European Company was recognized as a Community objective on 1985. An SE may “move” freely within the EU as if it operates in one jurisdiction. The relevant regulation does not cover taxation, competition, intellectual property or insolvency laws.
EU Tax Policy

Direct Taxes - Proposed Tax Harmonization Initiatives -

• **Common Consolidated Corporate Tax Base (CCCTB)**

  Allows companies with presence in more than one Member State to compute group taxable income according to one set of proposed rules, those of the new EU tax base. Advantages:

  - Transparency promotion, clarity and simplification, significant reduction in tax related compliance costs (e.g. as resulting from transfer pricing rules, the lack of cross-border loss compensation, etc.); and cross-border offsetting of profits and losses.
  
  - Solutions for current tax problems linked to cross-border activities and the restructuring of groups of companies.
  
  - Reduces MS “risk”, that their tax laws or practices may be declared as incompatible with the EC Treaty.
EU Tax Policy

Direct Taxes - Proposed Tax Harmonization Initiatives CCCTB (cont.)

- Recent Commission initiatives (Feb. - April 2006):
  - The work of the CCCTB project's subgroup on taxable income (definitions of taxable income, the treatment of income from sales of goods, and the treatment of unrealized income) and Progress Report April 5, 2006.
  - International taxation aspects of CCCTB.
  - The territorial scope of CCCTB to examine the suitability of source and residence rules and to help determine what income (by source) and which companies (by tax residency) should be covered.
  - The administrative framework, audit rules, legal interpretation, rulings, and dispute resolution system for an EU common consolidated corporate, and
  - Treatment of Banks Under Company Tax Base.
Recent EU Tax Developments

EU Tax Policy

Direct Taxes - Proposed Tax Harmonization Initiatives -

- **Home State Taxation for Small and Medium Sized Enterprises ("SME")**

  Allows SME’s to apply the corporate tax rules of their residence state to subsidiaries and permanent establishments in other participating Member States, for five years. This would address tax issues which hamper SME’s cross-border activities:
  - high compliance costs; and
  - problems with cross-border loss-offset.
Main Tax Directives


- Designed to eliminate tax obstacles in the area of profit distributions between groups of companies in the EU by:
  - abolishing withholding taxes on payments of dividends between associated companies residents of different MS; and
  - preventing double taxation on a parent company level on profit distributions from its subsidiary.

- The qualifying holding is 20% at present. This will be gradually reduced to 15% as per January 1, 2007 and 10% as per January 1, 2009.

- Under the amended Directive, the list of legal forms is extended to include entities such as the European Company and European Co-operative Society.

- Indirect holding through a permanent establishments (“PE”) may, under certain conditions, qualify under the amended Directive.
Main Tax Directives


- In force since January 1992.
- Facilitates mergers, divisions, and transfers of assets and exchanges of shares involving companies of different Member States.
- Provides for the deferred taxation of capital gains arising from cross-border company restructuring carried out in the form of mergers, divisions, transfers of assets or exchanges of shares.
- Provides for capital gains exemption when the receiving company holds shares in the transferring company. The holding threshold required for this exemption is now set consistent with that of the Parent-Subsidiary Directive (i.e. reduction from 20% to 10%).
Recent EU Tax Developments

Main Tax Directives

Mergers Directive (cont.)

• “Partial divisions” are now covered by the Directive. This allows the transfer of branches of activity into separate subsidiaries under the Directive’s deferred taxation regime. The splitting company is not dissolved and continues to exist – it transfers part of its assets and liabilities (constituting one or more branches of activity) to another company. In exchange, the receiving company issues securities representing its capital. These securities are transferred to the shareholders of the transferring company.

• This Directive now applies to:
  - new legal entities, e.g., European Company, European Co-operative Society.
  - non-resident “fiscally transparent” companies.
Recent EU Tax Developments

Main Tax Directives

Cross Border Mergers of LLC’s (Directive 2005/56/EC)

• Adopted on October 26, 2005.
• The Directive obliges MS to allow mergers between LLC’s from other MS, if such merger is allowed under domestic law.
• The Directive’s main aim is to apply to small companies that are less likely to use the European Company (SE).
Main Tax Directives


• The Interest and Royalties Directive (in force – January 1, 2004) is designed to eliminate withholding tax ("WHT") obstacles in the area of cross-border interest and royalty payments to beneficial owners within a group of companies by:
  - Abolishing WHT on interest and royalty payments arising in a MS;
• These interest and royalty payments shall be exempt from taxes in that MS provided that the beneficial owner of the payment is a company or permanent establishment in another MS.
• No WHT where direct holding of 25% in EU resident companies / PE exists (or a holding by a third party of 25% in the two related companies).
• Some countries require minimum shareholding period (2 years).
• There are transitional arrangements for certain countries.
Main Tax Directives


- MS automatic exchange of information on cross-border interest payments from EU paying agent to EU individuals.
- Based on the OECD Agreement on Exchange of Information on Tax Matters, bilateral agreements were concluded on 2004 with Switzerland, Liechtenstein, San Marino and Andorra.
- A similar agreement with the US is being considered.
ECJ - General

- The ECJ is composed of 25 judges and 8 Advocate-Generals (AG’s).
- Judges and AG’s are appointed by common accord of the Member States and hold office for a renewable term of six years.
- The ECJ may ask the AGs to give their opinion regarding the case at hand - generally, where new points of law arise and before handing its judgment.
- The ECJ follows the AGs’ opinion in most cases.
- Recent ECJ decisions have significantly impacted several fields of tax law, including thin capitalization rules, CFCs, participation exemptions, consolidated tax returns, etc.
- Note – the current EC Treaty provisions numbering is used in this presentation.
Recent EU Tax Developments

Selected ECJ Cases

Lankhorst-Hohorst (December 12, 2002)

• **Background**: Lankhorst-Hohorst GmbH (LH), is a German company which received financing from a non-German (Dutch) grandparent company. The interest paid was deemed to be a profit-distribution under German thin-cap rules, which only applied to non-resident lenders.

• **Decision**: The Court found that the relevant German law dealing with taxation of interest paid by a subsidiary to its parent company was discriminatory in that it differentiated between resident and non-resident companies and was contrary to the Freedom of Establishment principle found in the EC Treaty.
Lankhorst-Hohorst (cont.)

• **Effects & Consequences:**
  - Germany – amended its thin-cap rules, i.e. providing for a similar treatment to resident and non-resident companies.
  - Other Member States – several Member States had thin-cap rules which applied only to non-resident parent companies, among them the UK, France, Spain, Belgium, Portugal and Denmark:
    • The UK - largely amended its thin capitalization rules via the Finance Act 2004 and replaced them with transfer pricing rules, which now cover both domestic and cross-border transactions;
    • Spain - amended its anti-avoidance rules concerning thin capitalization by restricting their application to parent companies that are residents of non-EU countries;
    • France - the High Court declared French thin-cap rules are in violation of EU law.
Recent EU Tax Developments

Selected ECJ Cases

Bosal (September 18, 2003)

• **Background**: Bosal Holding B.V., held interests in a number of subsidiaries in the Netherlands and in other EU Member States. Bosal had financed these investments with interest bearing debt. With respect to the investments, the Dutch participation exemption regime applied. As a result, costs (such as interest costs) incurred in connection with such investment were not deductible. An exception to this rule: if the income of the subsidiary is taxable in the Netherlands, irrespective of whether the subsidiary actually pays any tax, the costs will be deductible.

• **Decision**: The ECJ held that Dutch tax rules regarding the non-deductibility of expenses relating to EU subsidiaries, are incompatible with the freedom of establishment principle and the Parent - Subsidiary Directive.
Recent EU Tax Developments

Selected ECJ Cases

Bosal (cont.)

• Effects & Consequences:
  - The Netherlands –
    • The Dutch Government announced thin-cap legislation that will limit the deductibility of interest on inter-company debt to equity ratio (3:1).
    • In addition, the legislation severely restricts the right of Netherlands holding and/or finance companies to carry backward or forward tax losses in an effort to limit the “damage” of the Bosal case.
  - Other Member States – Those who employ an exemption system for dividends received from a domestic subsidiary and a credit system for dividends received from a 'foreign' EU subsidiary, may be in violation of the EC Treaty.
Recent EU Tax Developments

Selected ECJ Cases

Marks & Spencer (December 13, 2005)

- **Background**: Marks & Spencer plc (M&S), a UK resident company, held (through a Dutch holding company) subsidiaries in Germany, Belgium and France. Consistently from the middle of the 1990s, those subsidiaries began to record losses. M&S asked for recognition of these losses, under UK group relief law. The UK Inland Revenue did not allow this, as under UK tax law a company is entitled to group relief only for its UK resident subsidiaries.

- **ECJ Decision**: The principles underlying the UK's group relief system were not as such contrary to the EC Treaty (freedom of establishment). However, as drafted in their current form, the group relief rules in the UK are unduly restrictive because they prohibit the deduction of losses by a UK parent in circumstances where it is impossible for the subsidiary to use those losses in its jurisdiction.
Recent EU Tax Developments

Selected ECJ Cases

Marks & Spencer (cont.)

• Effects & Consequences:
  - The U.K. Parliament published (April 7, 2006) the 2006 Finance Bill:
    • Statutory recognition of the extended scope of U.K. group relief in accordance with the ECJ M&S judgment so that losses of group companies resident in other EU Member States which cannot be relieved in the State of residence, will be eligible for U.K. group relief.
    • Anti-avoidance rules to deny U.K group relief where a main purpose is to generate UK group relief.
Recent EU Tax Developments

Marks & Spencer (cont.)

• Effects & Consequences:
  - The Netherlands has already introduced a proposal for domestic legislation so that EU subsidiaries can be included in a Dutch fiscal unity, i.e., losses incurred by the subsidiary could be offset directly against Dutch profits, subject to certain restrictions.
  - In countries such as Denmark and Austria legislation has been amended in order to allow cross-border relief.

Sevic (December 13, 2005)
Domestic corporate rules (Germany) that generally disallow the registration of cross border mergers in a trade court registrar, but only domestic mergers registration, are incompatible with EC Treaty (freedom of establishment).
Recent EU Tax Developments

Selected ECJ Cases

Cadbury-Schweppes (pending)

- **Background:** Cadbury Schweppes Plc (“Cadbury”) is a UK resident company. It is the parent of a group of companies including two indirect 100% Irish subsidiaries. These subsidiaries were subject to a tax rate of 10% within the International Financial Services Centre in Dublin. The Inland Revenue applied UK CFC rules and taxed Cadbury on the Irish companies’ profits, accordingly.

- **Question:** Compatibility of UK CFC rules with EC Treaty freedom of establishment.
Recent EU Tax Developments

Selected ECJ Cases

Cadbury-Schweppes (cont.)

- In the past, the Commission has considered these CFC rules as generally justified.
- On December 13, 2005, a full Court hearing (13 Judges) before the ECJ took place.
- Potential Effects & Consequences:
  - If the ECJ determines that UK CFC rules constitute a restriction on the EC Treaty freedom of establishment, and if the restriction is not proportional and therefore not justifiable, the case may force revisions of CFC legislation in other Member States.
  - France and Spain have already modified their CFC rules, so that these rules apply only with respect to certain off-shore entities and not with respect to other Member States tax systems (proportional application).
- Opinion: A.G. Leger (May 2, 2006): limited application of the UK CFC rules with respect to profits of UK subsidiaries in other MS.
Recent EU Tax Developments

(Pirelli) Test Claimants in Class IV of ACT G. Litigation (pending)

- **Background**: UK ACT regime: tax credit on dividends paid to shareholders - advanced payments of corporate income tax, paid in reference to consequent dividend distributions. Credit is provided at shareholders level. Previously, in the Metallgesellschaft/Hoechst joint cases, different treatment to foreign and UK resident shareholders was found as incompatible with EC law.

- **The question**: Whether the UK is required to provide foreign resident shareholders with the same ACT treatment (i.e. similar credit) as UK resident shareholders, even if their dividend payments were not subject to UK income tax (the UK has replaced the ACT regime).

- **Opinion**: According to A.G. Geelhoed, the UK is not required to provide foreign resident shareholders with the advanced credit on dividends received from the UK, unless the UK did impose ACT on such distributed profits and if a tax treaty that provides equal treatment, applies. If the UK does not follow this line, it may infringe the EC freedom of establishment and the free movement of capital (similar reasoning of A.G. Geelhoed in C-446/04 Opinion of April 6, 2006).
Test Claimants in FII G. Litigation (pending)

- **Background**: UK dividend regime. A UK company receiving a dividend from a non-UK subsidiary is taxable on the dividend and is entitled to foreign tax credits. Contrast this with where a UK company receives a dividend from a UK subsidiary where such dividend is exempt from tax. Furthermore when the UK ACT regime was in effect there was a requirement to account for ACT on dividends paid out of the UK parent which had been funded by dividends paid to the UK from EU subsidiaries.

- **The question**: Whether the UK system of taxing foreign dividends and exempting UK dividends is in breach of the EC Treaty and further whether the requirement to account for ACT on the onward payment of these dividends was in breach of the EC Treaty.

- **Opinion**: According to the A.G. Geelhoed, both of the UK provisions outlined above are in breach of the EC Treaty.

- **UK reaction to AG opinion of 6 April 2006** – immediate consultation with business regarding how to deal with this fundamental change in the UK taxation of dividends.
Denkavit (pending, April 27, 2006)
• A.G. Geelhoed: WHT on dividend payments to non-resident shareholders should not lead to more burdensome taxation.

Petri Manninen (September 7, 2004)
• The Finnish corporate tax credit system allowed a corporate tax credit to a domestic shareholder on dividends received within Finland but not on dividends received from another MS.
• Preliminary ruling: is this regime incompatible with the EC Treaty (free movement of capital) and whether possible derogations apply if taxpayers are not in equal situation.
• ECJ: these Treaty provisions preclude domestic tax laws that allow credit to shareholders only on dividend received from companies in the same MS.
Recent EU Tax Developments

Selected ECJ Cases

CLT UFA SA (February, 23 2006)

- **Preliminary ruling**: Less favorable tax treatment to a branch of a corporation, resident of another MS.
- Germany imposed a less favorable income tax rate on a branch of a Luxemburg resident company, than the tax rate that usually applies on profits of a German subsidiary that were fully distributed to a foreign corporation.
- The ECJ concluded that such tax treatment is incompatible with the EC Treaty (freedom of establishment and equal treatment to domestic legal entities and entities which are residents of other MS, respectively).
- National courts should determine the tax rate in such circumstances, based on EC law and case law.
- Confirmation of the choice of legal form in the host MS.
D. case (July 5, 2005)

- **Preliminary ruling**: different tax treatment to residents of other MS may be allowed on the basis of bilateral income tax treaty.
- A German resident had 10% of his assets in a Dutch real estate. He was subject to Dutch wealth tax, and was not entitled to personal allowances. Yet, residents of Belgium were entitled to such allowances according to a Dutch – Belgian tax treaty.
- The ECJ: a taxpayer that hold only minor part of assets in another MS is not in a comparable situation to a resident of that MS (i.e., different treatment is allowed – reference to the Gilly case).
- The EC Treaty does not preclude more favorable tax treatment to residents of certain MS, on the grounds of an applicable bilateral tax treaty, since EU harmonization was not achieved yet (reference to the Saint-Gobain case).
- This landmark decision is observed by some as a step-back in EU tax harmonization.
EU – Israel Relations

• EU relations with Israel are governed by the Euro-Mediterranean Partnership established through the EU-Israel Association Agreement (November 20, 1995) and the regional dimension of Barcelona Process (adopted on November 27-28, 1995).

• The main objectives include: provisions on freedom of establishment and liberalization of services, the free movement of capital and competition rules, the strengthening of economic cooperation on the widest possible basis and cooperation on social matters, supplemented by cultural cooperation.

• A Minister Association Council meets once a year. This is to be supported by an Association Committee with responsibility for implementing the Agreement. The Agreement reinforces the arrangements for free trade in industrial products, which have been in force since the late 1970s.
EU – Israel Relations (cont.)

- The Agreement is part of a cooperation system of the EU and its “neighbors”.
- Israel was the first non-EU country to be associated to the European Community’s Framework Program for Research and Technical Development (RTD).
- Israel's special status is the result of its high level of scientific competence and the longstanding relations in scientific and technical cooperation between Israel and the EU.
- Both parties reaffirmed their commitment to mutually open their procurement markets.
EU VAT Law

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Main Sources EU VAT Rules

- 6th EC VAT Directive (most important)
- 8th VAT Directive (VAT Refunds to Foreign, EU Businesses)
- 13th EC VAT Directive (VAT Refunds to Foreign, non-EU Businesses)
- Case law European Court of Justice
- If EU Directive is more advantageous than national rules, Directive prevails
Sixth EC VAT Directive - Structure

- Scope
- Territorial application
- Taxable persons
- Taxable transactions
- Place of taxable transactions
- Chargeable event and chargeability of tax
- Taxable amount
- Rates
- Exemptions
- Deductions
- Persons liable for payment for tax
- Obligations of persons liable for payment
- Special schemes, Simplification procedures
- Transitional provisions, arrangements and measures
EU VAT Law

Short Description Main Features EU VAT System

- **Supplies of goods**
  - Domestic
  - To other EU country (intra-Community supplies / distance sales)
  - To non-EU country (export)

- **Intra-Community acquisitions of goods**
  - From other EU country

- **Import of goods**
  - From non-EU country

- **Supplies of services**
  - Deemed to be performed in country:
    - Where supplier established
    - Where recipient established
    - Where EU VAT ID no. recipient
    - Where work performed
  - Where property located
  - Where transport
  - Where actual use
Short Description Main Features EU VAT System

• **Rates and exemptions**
  - 0% rate: burden of proof
  - General rate 15% - 25%
  - Reduced rates
  - Exemptions: strictly applied (e.g. financial sector, medical sector, immovable property)

• **Who is liable for payment of VAT**
  - Supplier / acquirer / importer
  - Recipient (reverse charge)
  - Fiscal representative

• **Administrative requirements**
  - Invoicing
  - Reporting
  - Statistical reporting intra-EU movements
Foreign Business

Obligation to VAT register in EU country if local VAT due (e.g. acquisition VAT, local supply)

- VAT registration as local taxable person
  - Permanent establishment
  - Local entity

- VAT registration as non-established taxable person
  - Direct registration
  - Registration through Fiscal Representative (in some countries compulsory for non-EU entities)
  - Special ‘non-EU electronic services’ registration
Important Facilities for Goods

**Import VAT**
- Due upon importation
- Deferment schemes (delay)
- Avoiding actual payment schemes (same time declaring and deducting on VAT return, e.g. the Netherlands)

**Customs warehousing**
- Non-EU goods, non-imported
- Avoiding VAT registration
- Transactions in warehouse not subject to VAT (0%)
- Processing under Customs Control
- Avoiding VAT cash flow
Important Facilities for Goods

VAT warehousing
- EU goods
- Only for specific types of goods
- Transactions not subject to VAT (0%)
- Avoiding VAT cash flow

EU Central Distribution Centre
- VAT registration in one country for all supplies
- Streamlining flow of goods required
EU VAT Law

International Services

Very complex area of VAT

- Over 10 main criteria to determine place of taxation
- Most commonly applied criterion has 12 subcategories
- Numerous cases by ECJ (from gambling machines to veterinarians to restaurants)
- Interpretation of criteria varies substantially across EU (not very harmonized!)
- Severe scrutiny by tax authorities (assessments with penalties and interest!)
- Also non-taxable persons (e.g. pure holding companies) can face VAT liabilities towards tax authorities on incoming services from abroad
- Opportunities and risks (especially for services to consumers through the internet)
- FCE Bank case: internal activities outside the scope of VAT (…)
Selection of Crucial Case Law ECJ

(Over 300 cases on VAT!)

**Polysar** – pure holding company is not taxable person

**INZO** – what if supplies do not commence

**Fini** – end of activities

**FCE Bank** – (no) VAT on activities head office for its branch

**Safe Rekencentrum** – supply of goods is EU wide concept

**Mohr** – subsidies only subject to VAT if consumption

**Berkholz, DFDS, ARO Lease** – definition of permanent establishment for VAT

**Schmeink & Strobel** – repairing incorrectly charged VAT

**SDC / CSC / Skandia** – scope of exemption financial services

**EMAG** – exemption intra-Community supplies of goods

**Kretztechnik** – input VAT on issue of shares

**Debouche** – fully exempted taxable person in EU will not get foreign refund

**Halifax** – abuse of rights
Recent Developments in Selected Member States
United Kingdom

Issues

- Overview of CT regime
- Corporation Tax anti-avoidance – shares as loan relationships
- Corporation Tax anti-avoidance – anti-arbitrage
- Double Tax Relief (DTR) anti-avoidance
United Kingdom
Overview of CT regime

- Corporation Tax rate is 30%
  - Trading losses carried forward indefinitely but only utilised against profits from same trade
  - Non-trade losses carried forward indefinitely
- Capital gains taxed at same rate
  - Capital losses only utilised against capital gain
  - Substantial Shareholding Exemption
- Group provisions allow current year loss relief against profits of another group member
United Kingdom
Overview of CT regime (cont)

- No dividend withholding tax
- Withholding tax rate on interest & royalties is 20%
  - Reduced to 0% under most Treaties
  - Reduced to 0% under Interest & Royalties Directive
- Dividends from UK shareholdings are exempt
- Dividends from foreign shareholdings are taxable
  - Foreign tax credit for direct taxes suffered (e.g. withholding taxes)
  - Foreign tax credit for indirect taxes suffered if greater than 10%
UK Tax Developments

United Kingdom
Overview of CT regime (cont)

- Extensive CFC rules
- No interest allocation rules
- Extensive specific anti-avoidance rules to deal with, inter alia,
  - Interest deductions
  - Foreign exchange differences
  - Income into capital schemes
  - Value shifting & dividend stripping
UK Tax Developments

S91A FA 1996 – shares subject to third party obligations

Applies where:

Company holds a share subject to outstanding third party obligations;
and
Nature of share is such that the fair value of the share is likely to increase at a rate which represents a return on an investment of money at a commercial rate of interest (if ignore fair value movements due to forex)
UK Tax Developments

S91B FA 1996 – non-qualifying shares

Applies where company holds shares meeting one out of:

- **Condition 1 (91C)**: Shares not “income producing” but are such that the value of the share is likely to increase at a rate which represents a return on an investment of money at a commercial rate of interest.

- **Condition 2 (91D)**: Redeemable shares designed to produce a return on an investment of money at a commercial rate of interest (subject to unallowable purpose test / public issue exemption).

- **Condition 3 (91E)**: Shares (together with derivative contracts or similar) designed to produce a return on an investment of money at a commercial rate of interest.
Shares Treated as Loan Relationships

Broad effects of being caught by either s91A or 91B:

• Changes in fair value of shares (both profits & losses) post 16 March 2005 taxed as if share were a loan relationship

• Dividends treated as taxable (even if from a UK company)

• Deemed disposal/re-acquisition of share on 16 March 2005 (gain/loss held over under s116 TCGA 1992)

• Gain will crystallise on disposal of share or if share ceases to be s91A/B share
UK Tax Developments

Shares treated as loan relationships – Example 1

- FV of shares in Finco likely to mirror interest like investment
- Are loans “money placed at interest” (income producing assets), hence shares in Finco not caught?
- Are returns on loans not a deposit rate, hence shares in Finco not caught?

UK Holdco

Sub 1

Finco

Group Loans
Shares treated as loan relationships – Example 2

1. UKCo buys CashCo for £95.

2. After 1 year, bank pays final call on shares, so CashCo then worth £100. Capital gain of £5.
   - After 1 year, bank pays remaining 99.99p per share
   - CashCo now worth £100: UKCo paid £95 for it
   - UKCo liquidates CashCo, yielding capital gain of £5 (on what is effectively interest income)
   - Now caught by s91A, so £5 taxable as loan relationship income

Bank sets up CashCo with 100 £1 shares
- 0.01p per share is payable by bank now, 99.99p payable in 1 year
- UKCo buys CashCo for £95 now
United Kingdom

*Corporation tax anti-avoidance - arbitrage*

- Proposed new legislation to counter schemes using:
  - Hybrid entities, i.e., an entity which is recognised as a taxable person under one tax code, but whose profits/gains/losses are also within the scope of the same or another tax code for one or more persons; or
  - Hybrid instruments, i.e. payments which can be characterized in differing ways in different jurisdictions, e.g., a dividend which is viewed as an interest payment

- Applies both to intra-UK and cross border schemes.

- Applies where there is:
  - double deduction for same expense, or UK deduction for payer where recipient not taxed on the receipt (“deductions”); or
  - amounts received by a company in a non taxable form (“receipts”).
United Kingdom

*Corporation tax anti-avoidance – arbitrage (continued)*

- Applies to deductions or receipts arising/accruing on or after 16 March 2005
- But does not apply to existing schemes involving “deductions” where:
  - connected parties not involved; and
  - scheme unwound before 1 July 2005
- Consequence for failing to conform with the proposed rules will result in the denial of the claimed deduction.
Avoidance involving tax arbitrage – Deductions
Rule A - double deductions
Example

- Scheme using a hybrid entity
- Tax deduction for interest in both UK and in For Co
- UK deduction denied under Rule A unless UK tax advantage is not one of the main purposes of the scheme
UK Tax Developments

Avoidance involving tax arbitrage – Deductions
Rule B – deductions with no taxable receipt

Example 1

- Scheme using hybrid entity
- UK tax deduction for interest
- Interest income not taxed in the For Co
- UK deduction for interest denied under Rule B unless tax advantage is not one of the main purposes of the scheme
UK Tax Developments

United Kingdom
Double Tax Relief ("DTR") anti-avoidance

Generic DTR

- Applies to any company, individual or partnership which enters into a scheme to claim DTR if:
  - Tax avoidance is one of scheme’s main purposes;
  - Inland Revenue issues a notice to direct that the legislation applies; and
  - Scheme falls within one of 5 prescribed circumstances:
    - Foreign tax is not properly attributable to the source from which the income or gain is derived, or
    - Payer of the foreign tax (with associates) has not suffered the full economic cost of the foreign tax, or
United Kingdom
Double Tax Relief ("DTR") anti-avoidance (continued)

Generic DTR

- A claim or election which could have been made and which would have reduced the amount of credit for foreign tax was not made (or a claim was made to increase the credit for foreign tax), or
- The foreign tax credit reduced the tax payable to less than would have been payable if the transaction had not occurred, or
- The income subject to foreign tax was acquired as consideration for a tax deductible payment.

- Where the legislation applies, the DTR claim is limited to cancel the effect of the scheme.
- Applies to DTR claims regarding foreign tax paid on/after 16 March 2005.
UK Tax Developments

United Kingdom
Double Tax Relief ("DTR") anti-avoidance

Measures aimed at underlying tax schemes

- Two new rules for dividends paid on/after 16 March 2005:
  - Where a foreign country taxes companies on a consolidated basis, DTR for dividends calculated using average tax rate for group. The rule will be changed so that underlying tax on Acceptable Distribution Policy dividends will be calculated on a stand alone basis.
  - Underlying tax relief denied for dividend which is tax deductible in the foreign jurisdiction from which it is paid.
Germany - Latest Tax Developments

Stefan Brunsbach
International Tax Partner
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Germany - Latest Tax Developments

Germany Issues

• General Information on German Taxes
• Special Tax Regulations
• German Inbound Tax Planning Strategies
General Information on German Taxes

Most important taxes and tax rates

- Individual income tax: 19% - 42%
- Corporate income tax: 25%
- Solidarity surcharge: 5.5% on income tax or withholding tax
- Trade tax: 9% - 20%*
- Withholding tax: usually 20%
- VAT: 16% (19% as of 2007); 7% for special goods
- Real estate transfer tax: 3.5%

* Effective rate depends on the location of the business, tax is deductible for corporation tax purposes.
General Information on German Taxes

Basic example (corporations)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income before taxes</td>
<td>100.0</td>
</tr>
<tr>
<td>Trade tax (say 16.2%)</td>
<td>&lt;16.2&gt;</td>
</tr>
<tr>
<td></td>
<td>83.8</td>
</tr>
<tr>
<td>CIT (25%)</td>
<td>&lt;20.95&gt;</td>
</tr>
<tr>
<td>Solidarity surcharge (5.5%)</td>
<td>&lt;1.15&gt;</td>
</tr>
<tr>
<td></td>
<td>61.70</td>
</tr>
<tr>
<td>Total taxes</td>
<td>38.30</td>
</tr>
<tr>
<td>Effective tax rate*</td>
<td>38.30%</td>
</tr>
</tbody>
</table>

* As interest on long term debt are only deductible for trade tax purposes at 50%, interest costs will reduce the effective tax burden only by some 33% of the interest payments.
General Information on German Taxes

Basic income tax principles

- Partnerships (like OHG, KG (including) GmbH & Co. KG):
  - Transparent for income tax purposes; income will be taxed at partners’ level.
  - Subject to trade tax on its own.
  - Specific income/expenses at partners’ level are allocated for German income/trade tax purposes to the partnership’s level.

- Corporations (like GmbH or AG):
  - Subject to income tax and trade tax on its own.
General Information on German Taxes

Determination of tax base

- Income tax base generally derived from German GAAP accounting profits; however, subject to specific tax adjustments, for example, with regard to specific:
  - Accruals (e.g. Pension, anticipated losses, …)
  - Expenses (e.g. entertainment, …)
  - Tax exempt income (e.g. dividend income, …)

- Trade tax base generally derived from income tax base, however, subject to further adjustments, for example:
  - Interest on long term debt disallowed for deduction at 50%.
Special Tax Regulations

Dividend income/capital gains

Basic rule
- Dividend income from investments in corporations and capital gains on the disposal of shares in corporation are generally tax exempt at 95% at the level of corporate shareholders regardless of - residency of the corporate subsidiary - minimum shareholding or - holding periods

Considerations
- Specific participation exemption rules for trade tax purposes regarding dividend income
- CFC legislation
- Tainted shares
Germany - Latest Tax Developments

Special Tax Regulations

**Tax grouping**

- **GmbH 1**
- **GmbH 2**

**Basic rule**
- Domestic tax grouping possible, for income and trade tax provided:
  - More than 50% voting rights as of the beginning of the financial year of the subsidiary
  - Profit and loss pooling agreement

**Considerations**
- Controlling entity can also be an (actively trading) partnership or a registered branch of a foreign corporation.
- A Partnership cannot be a subsidiary in a tax group (potential trade tax disadvantages).
- Impacts on ECJ decision on Marc & Spencer case concerning cross border tax grouping still open.
### Special Tax Regulations

#### Basic rule
- **Loss carry back**: one year CIT only; max. € 511,500.
- **Loss carry forward (CIT, TT)**: no time limitation, however, subject to minimum taxation rule: 40% of current years income in excess of € 1m always taxable.

#### Considerations
- Specific tax loss forfeitures rules exist, in particular in case of:
  - Change in ownership in connection with contribution of predominantly new assets
  - Reorganizations (such as merger; contribution); either no transfer of losses or only under specific pre-conditions.

### Tax loss utilization

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NOLs</strong></td>
<td>10,000</td>
<td>8,600</td>
<td>7,000</td>
<td>6,000</td>
</tr>
<tr>
<td><strong>Income</strong></td>
<td>2,000</td>
<td>2,000</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td><strong>Taxable</strong></td>
<td>400</td>
<td>400</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Tax at 40%</strong></td>
<td>160</td>
<td>160</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Special Tax Regulations

Thin cap rules

Basic rule

- German thin cap rules apply to German corporations, if
  - lender participates substantially (directly or indirectly) in the borrowing corporation at more than 25% (“related party loan”)
  - interest exceeds the allowable debt/equity ratio (safe haven) of 1.5:1
- Rules also applicable to partnerships, if a corporation holds more than 25% in the partnership
- Third party loan also qualifies as related party loan if third party (such as a bank) is entitled to a recourse to the shareholder or related party to the shareholder, e.g. by virtue of a guarantee or letter of comfort.

According to view of the tax authorities in case of third party loans application of thin cap rules is limited to so called “back to back financing” (secured by long-term interest bearing deposits)
- Equity is basically the German GAAP equity at the end of financial year preceding the year under review
Special Tax Regulations

Thin cap rules (cont.)

Considerations

• Equity has to be reduced by the book value of investments in subsidiaries, unless the company under review qualifies as a holding.
• A lower tier subsidiary of a holding has no safe haven apart from specific exceptions
• No safe haven at all in case of internal debt push down structures
• No safe haven in case the interest is not agreed as a fixed portion of the loan
• Specific regulations applicable in case of partnerships
• To the extent debt funding is qualified as being outside the scope of the German thin cap rules interest expenses will be re-qualified into hidden profit distribution, i.e.:
  - Interest will not be deductible.
  - Potential implication of assumed dividend (e.g. WHT, CIT uplift)
• Many open questions!
Special Tax Regulations

Thin cap rules (cont.)
Basic example

ForCo  
HoldCo  
OpCo  
OpCo

ForCo  
OpCo I  
OpCo II

Equity 200  
Debt 300

Tax group

Germany - Latest Tax Developments
Dividends/Royalties
- Generally subject to 21% WHT
- Under EU parent/subsidiary Directive: 0%
- Reduced DTT rates
- Direct application of reduced rates upon payment requires advanced application by the recipient with German revenue authorities; otherwise refund procedure
- Anti treaty/Directive shopping rules to be considered

Interest
- Generally, no WHT under domestic law on interest payments regardless of residency of the recipient.
German Inbound Tax Planning Strategies

Basic German inbound structure

- ForCo
- German HoldCo
- OpCo
- Foreign Sub
- Debt/Equity
- Debt
- Bank
- Tax group

Achieved tax objections

- Interest relief on debt funding for German income tax purposes (trade at 50% only)
- Income consolidations (offset of losses and profits) within Germany
- Dividend income/capital gains on disposal of shares (including Foreign Sub) tax exempt at 95% for German income tax purposes
- No 5% add-back on profit transfer within tax group
- No WHT on interest payments to ForCo
- WHT on dividends to ForCo depends on resident state of recipient
German Inbound Tax Planning Strategies

WHT optimization

Interposition of EU HoldCo:

Achieved tax objectives

- Dividend distributions within the EU to qualified corporate resident shareholders are exempt from German WHT according to parent/subsidiary Directive
- In case EU HoldCo is located in a territory which has no WHT on dividends to ForCo according to its national law or under the applicable DTT, German WHT can be avoided

Considerations

- Sufficient substance/business reasons according to German anti-treaty/Directive shopping rules required at the level of EU HoldCo
- Timing
Achieved tax objectives
- Cash repatriations from a German partnership to its foreign partners are not subject to German WHT regardless of the residency of the foreign partner

Considerations
- Sufficient substance required at the level of the HoldCo KG partnership to secure that tax grouping is possible and that the shares in OpCos are allocated tax wise to the holding partnership
- Foreign tax implications
- Exit scenarios
- Thin cap rules
German Inbound Tax Planning Strategies

Achieved tax objectives
- In case no single shareholder owns more than 25% of the shares in ForCo, German thin cap rules should not be applicable
- The loan granted to German limited partnership is deemed to be granted to ForCo under the German thin cap rules
- Because of ForCo’s shareholder structure German thin cap rules should not be applicable

Considerations
- Sufficient substance required at the level of the HoldCo KG partnership to secure that tax grouping is possible and that the shares in OpCos are allocated tax wise to the holding partnership
- Foreign tax implications
- Exit scenarios
German Inbound Tax Planning Strategies

Thin cap optimization (cont.)
- Equity boosting -

Achieved tax objectives

• Increase of equity relevant for the determination of safe haven available and as a consequence the debt funding capacity

Steps

• GmbH 1 transfers its going concern business to GmbH 2 in exchange for (one new) share.
• Upon the hive down GmbH 1 realizes all undisclosed reserves leading to a book gain for GAAP purposes
• For tax purposes, GmbH 2 accounts the transferred assets with book values of GmbH 1, so hive down is tax neutral
German Inbound Tax Planning Strategies

Thin cap optimization (cont.)
- Equity boosting -

Considerations
- Timing
- Deferred taxes
- Real estate transfer tax
- Tax avoidance

GmbH 1

Hive down of business

GmbH 2
German Inbound Tax Planning Strategies

**Thin cap optimization**  
- Avoidance of anti internal debt push down rules -

**Achieved tax objections**
- Avoidance of anti internal debt push down rules by debt funding of a dividend, instead of a prohibited leveraged acquisition of shares from a related party

**Steps**
- ForCo contributes shares in OpCo II into HoldCo in exchange for equity
- HoldCo distributes equity to ForCo
- HoldCo draws down loan to finance dividend

**Considerations**
- Foreign tax implication
- Thin cap rules
- WHT
- Timing
- Tax avoidance (tax authorities seems to request a one year period between the contribution and the dividend distribution).
Achieved tax objections

- Avoidance of RETT on internal group restructuring, e.g. interposing B between A and C

Steps

- Ultimate parent sets up E GmbH
- E GmbH as 0% GP and C as 100% LP form KG
- C transfers 6% (10%) to E-KG 100%
- A transfers shareholding in C into B

Considerations

- Income tax implications from implementation steps
- Potential trade tax leakage
- Increase of complexity of the group structure
Achieved tax objections

- Interest on loan granted to ForCo for the acquisition of interest in KG are deductible for German income tax purposes (trade tax 50%)
- Same applies with regard to debt financed equity contributions into KG

Steps

- ForCo draws down loan for the acquisition of interest in KG for the funding of an equity contribution
- Interest reduces income tax base of KG according to German income tax law (trade tax at 50%) due to specific German concept concerning the taxation of partnerships
German Inbound Tax Planning Strategies

Double dip structure (cont.)

Considerations
- Foreign tax implications
- Exit scenarios
- Thin cap rules
German Inbound Tax Planning Strategies

Achieved tax objectives

• Disposal of an independent going concern business unit to a third party on a tax free basis

Steps

• GmbH 1 transfers the business to GmbH 2 in exchange for (one new) share at statutory and tax book value
• GmbH 2 transfers the business to a limited partnership at FMV for statutory but at book value for tax purposes
• GmbH 2 takes up a loan to distribute the gain realized
• The shares in GmbH 2 are sold for nominal (equal FMV) consideration

Tax free sale of going concern business

1. Hive down of business
2. Debt financed dividend payment
3. Hive down of business
4. Sale of shares in GmbH 2

Germany - Latest Tax Developments
German Inbound Tax Planning Strategies

Considerations
- Effect on price
- Trade tax risk on dividend
- 5% add-back on dividend
- Economic rational/timing/tax avoidance

Tax free sale of going concern business (cont.)

1. GmbH 1
   - Hive down of business
   - GmbH 2

2. Debt financed dividend payment
   - GmbH 1
   - Hive down of business
   - GmbH 2
   - KG

3. Sale of share in GmbH 2
   - GmbH 1
   - KG
   - GmbH 2

Germany - Latest Tax Developments
The Netherlands - Latest Tax Developments

Paul Van Overloop
International Tax Partner
PwC The Netherlands
The Netherlands - Latest Tax Developments

The Netherlands
Issues

• 2007 Dutch Corporate Income Tax Reform
  - Reduction CIT rate
  - Participation Exemption Regime
  - Group Interest Box
  - Group Royalty Box
  - Loss Compensation
  - Depreciation Immovable Property

• Capital Tax

• Dividend Withholding Tax
In early 2004 the Dutch Ministry of Finance announced a revision of the Dutch Corporate Income Tax Act.

In April 2005, the Dutch Ministry of Finance published a memorandum entitled “Werken aan Winst” to further discuss the outlines of the new Corporate Income Tax Act 2007.


The proposal has not yet been approved by the Dutch Parliament.
The Netherlands - Latest Tax Developments

Why?

- Deterioration of the Dutch international tax competitive position
- Various judgements of the EU Court of Justice
Reduction Corporate Tax Rate

- As from January 2006: 29.6%
  (5.5% on the first Euro 22,689)
- As from January 2007: 29.1%
  (20% on the first Euro 41,000)
- With effect from 2007, reduction in two graduated steps, first to 27.4% and then to 26.9%
- Possible further reduction to 25%
Participation Exemption

- 5% shareholding requirement becomes a "hard" criterion
- Non-portfolio and subject to tax requirement will be abolished!
- But: passive subsidiaries that are not effectively subject to a sufficient level of taxation do not benefit from participation exemption
  - Indicative 10% rate
  - Credit will be given for underlying tax
Group Interest Box

• Optional - applicable at request of the group
  - Minimum period of probably three years

• Difference between group interest income and interest expense is taxed at 10%

• Only if the net group interest income exceeds third party interest income

Please note:
The group interest regime will be introduced provided that the European Commission does not qualify if forbidden state aid or harmful tax competition.
Group Royalty Box

- Optional
- Special royalty box with favourable reduced tax rate for group licensing activities
- Applicable to patents and possibly also to brand names.
- R&D expenses will initially be deductible at the standard CIT rate. If research and development results in patents, brand names etc, the royalty box may apply.
Loss Compensation

- Now: 3 year carry back, indefinite carry forward
- As from 2007: 8 year carry forward, limitation to 1 year carry back under review
- Transitional rules unknown
Depreciation of Immovable Property

- Now: annual depreciation is the difference between the acquisition value and the residual value of the building, divided over the economic life time.

- New regime: annual depreciation stops if fair market value of the real estate (land + building) has been reached (limitation to portfolio investments under review).

- Intention to introduce transitional provisions for new buildings.
Abolition Capital Tax

- Effective as per 1/1/06!
- Full abolition – also clawbacks resulting from share-for-share mergers
Dividend Withholding Tax

- The Dutch Ministry of Finance considers gradually abolishing dividend withholding tax in the future
- Current dividend withholding tax rate is 25%
  - Reduced under EU Parent-Subsidiary Directive and tax treaties
- The Dutch Ministry of Finance indicated gradual reduction of the dividend withholding tax rate in the next years
Spain - Latest Tax Developments

Ramon Mullerat
International Tax Partner
PwC Spain
Spain Issues

• Income Tax Laws Reform
• Fraud Prevention Law
• New Double Tax Treaties
• EU Infringement Procedures
• Thin Cap, CFC, Similar Taxation
• Spanish Holding Regime
• Discussion Panel – New Structures
Income Tax Laws Reform (1) Personal Tax

- Tax Reform Bill submitted to Parliament in March 2006
- Expected to Undergo Changes before 1 January 2007 entry in force
- Savings Income to be taxed at 18%: Interest, Dividend, Capital Gains
- Remaining Income to be taxed at reduced progressive rates
- Expatriate Special Tax Regime unchanged
Income Tax Laws Reform (2) Corporation Tax

- Corporation Tax Rate to be reduced 1% per annum until 30% is reached in 2011
- Most Investment Tax Credits to be suppressed progressively until 2011
- Important provisions that remain unchanged:
  - Participation Exemption, Foreign Tax Credits
  - ETVE Regime
  - Reorganization Regime
  - Amortization of Goodwill

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax Rate</th>
<th>Tax Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>35%</td>
<td>1</td>
</tr>
<tr>
<td>2007</td>
<td>34%</td>
<td>0,8</td>
</tr>
<tr>
<td>2008</td>
<td>33%</td>
<td>0,6</td>
</tr>
<tr>
<td>2009</td>
<td>32%</td>
<td>0,4</td>
</tr>
<tr>
<td>2010</td>
<td>31%</td>
<td>0,2</td>
</tr>
<tr>
<td>2011</td>
<td>30%</td>
<td>0</td>
</tr>
</tbody>
</table>
Spain - Latest Tax Developments

Income Tax Laws Reform (3) Non Residents’ Tax

Non-Treaty Rates to be changed as per the following chart:

<table>
<thead>
<tr>
<th>Income Type</th>
<th>Current Rate</th>
<th>New Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend &amp; Interest</td>
<td>15%</td>
<td>18%</td>
</tr>
<tr>
<td>Royalties</td>
<td>25%</td>
<td>24%</td>
</tr>
<tr>
<td>Capital Gains</td>
<td>35%</td>
<td>18%</td>
</tr>
<tr>
<td>PE Income</td>
<td>35%</td>
<td>30%</td>
</tr>
<tr>
<td>Other</td>
<td>25%</td>
<td>24%</td>
</tr>
</tbody>
</table>
Fraud Prevention Bill

- Bill submitted to Parliament in March 2006
- Expected to undergo changes before 1 January 2007 entry in force
- Increased Transfer Pricing Documentation Requirements
- More Detailed Rules for Intra-Group Cost Sharing Agreements
- Distinguishes 3 classes of low-tax jurisdictions
Spain - Latest Tax Developments

EU Infringement Proceedings

- Spain was warned by EU Commission in July 2005
- Warnings to remove differences between resident / non-resident taxation
  - Non-Resident Labour Income & Capital Gains Taxation
  - Research & Development Tax Incentives
  - Capital Tax (remains unchanged)
Spain - Latest Tax Developments

2004 Tax Reforms

- Spanish CFC Rules no longer apply to EU Resident Entities
- 3:1 Thin Capitalization Ratio does not apply to loans granted by EU Resident Related Parties
- Participation Exemption always applies to Treaty Subsidiary (Exc: Swiss)
**Requirements: Foreign Co**
- 5% equity interest or €6 million investment value
- 1 year holding period
- Foreign Co subject to analogous tax
- No tax havens as per Spanish list
- Foreign Co must be engaged in active business

**Requirements: ETVE**
- Can be a regular Spanish corporation
- Can also be a foreign corp. with tax residence in Spain
- Must have sufficient substance to manage investments
- Notice to Spanish tax authorities
Spain - Latest Tax Developments

ETVE & other tax benefits

Tax Benefits:
- Participation exemption for dividends and capital gains obtained by ETVE
- No withholding tax on dividend distributions from ETVE to the US (or to any other jurisdiction -except tax havens)
- Capital gain tax exemption when selling the ETVE
- No capital duty on contributions of shares
- Effective inapplicability of CFC legislation
- Interest: tax deductible (thin-cap ratio: 3:1, EU exception)
- Capital losses: tax deductible
New Structures for Spanish Investments

Issue
- Resident Capital Gains to be taxed at 30%
- Non-Resident Capital Gains to be taxed at 18%

Proposed Solutions
- Locate ownership out of Spain
- Locate ownership of assets used out of Spain in foreign Branch
Cyprus - Latest Tax Developments

Nicos Neophytou
Tax Partner
PwC Cyprus
Cyprus Issues

- Cyprus Main Features
- Cyprus Tax System
  - Residency Rules Apply
  - Permanent Establishment (PE)
  - Foreign Dividends Received by a Company
  - Profits from PE Abroad
  - Interest Received by a Cyprus Resident Co.
  - Transactions in Title
  - Withholding Taxes
  - Other Significant Issues
- Summary – Benefits of Cypriot Entities
Cyprus Main Features

- New legislation @ 1 January 2003
- EU & OECD Compliance
- Abolition of IBCs
- Uniform corporate rate @ 10% - no discrimination
- Transitional rules till 31 December 2005 - rate @ 4.25%
Residency rules apply:

- A company is resident and therefore taxable if management and control of the company is exercised in Cyprus
- Resident company taxed on worldwide income
Cyprus Tax System -
Permanent Establishment (PE)

• If company only has PE in Cyprus
  - Taxed in Cyprus on profits of PE only
• A PE is defined as a fixed place of business
  through which the business of the company is
  wholly or partly carried on (OECD definition)
Cyprus Tax System -
Foreign Dividends Received by a Company

• **Foreign dividends exempt when company owns more than 1% of the paying company**
  - Exemption not available if paying company is directly or indirectly engaged more than 50% in activities which result in investment income **AND**
  - The paying company is subject to tax at a rate of tax substantially lower than the Cyprus rate (i.e. lower than 5%)
Cyprus Tax System -
Foreign Dividends Received by a Company (continued)

• If exemption does not apply (e.g. <1% of shares of subsidiary are held by Cyprus Co) there is Special Contribution for Defence at the rate of 15%. Tax credit available against this tax.

• There is no corporation tax on dividends received

• If dividend is subject to defence contribution in Cyprus, Tax Credit is available unilaterally on Withholding tax; and if provided by DTT a Credit is also allowed on the underlying tax.
Cyprus Tax System -
Profit from PE Abroad

- Same treatment as dividend = Exempt
- Same restrictions as dividend
Cyprus Tax System -
Interest Received by a Cyprus Resident Co.

• Active Interest
  - Interest relating to ordinary activity of company or interest closely connected to ordinary activity such as:
    Banking, Finance, Inter-company finance, interest on Debtors and bank current accounts
  - Normal corporation tax at 10%

• Passive Interest
  - All other cases
  - A combination of corporation and defense tax resulting in an effective tax rate of 15%. The 15% rate rarely applies in practice. Applies mostly to interest paid on bank deposits.

• Proposals are made for ALL interest to be taxed at 10%

Cyprus - Latest Tax Developments
Cyprus Tax System -
Transactions in Titles

- Profit arising from transactions in Titles is tax exempt
- “Titles” are defined as
  - Shares
  - Bonds
  - Debentures
  - Founder and other titles of companies or legal persons and rights thereon.
- A tax ruling in Cyprus may be possible to confirm whether a certain instrument qualifies under the definition of “Titles”.

Cyprus Tax System - Withholding Taxes

For payments made to non residents

- Dividend: No tax
- Interest: No tax

Royalty:
  - No tax - When intangible used out of Cyprus
  - 10% subject to treaty - When intangible used in Cyprus

Cyprus - Latest Tax Developments
Cyprus Tax System -
Other Significant Issues

• No thin capitalisation rules

• Arms length principle

• Liberal expense deductibility

• No stamp duty on contracts relating to matters outside Cyprus

• Stamp duty on share issue applies, but can be minimised to negligible amounts by issuing shares at a premium
Cyprus Tax System -
Other Significant Issues (continued)

- EU directives as from date of joining in full applicability 1 May 2004
  - Parent/subsidiary
  - Interest & Royalty
  - Savings Directive
  - Merger Directive
- Losses carried forward with no restriction
- Group taxation – loss relief available to group companies with 75% direct or indirect holding relationship.
Cyprus Tax System -
Other Significant Issues (continued)

Merchant shipping law - Applies until year 2020

Ship-owning operations
- No tax on profits from the operations of Cypriot registered vessels or on dividends from a ship-owning company
- No CGT on sale of transfer of Cypriot vessels or the shares of a Cypriot ship-owning company
- No income tax on the emoluments of officer or crew on board Cypriot registered vessels

Ship-management operations
Ship-management activities = crewing, technical and commercial management of ships
Taxed at either 4.25% or at rates equal to 25% of rates used to calculate tonnage tax of vessel under management
Summary – Benefit of Cypriot Entities

- Capital gains exempt from taxation in Cyprus
- Dividend income exempt from taxation in Cyprus (with minor limitations)
- No withholding tax on payment of dividends, royalties and interest abroad
- EU Parent – Subsidiary Directive applies as from 1 May 2004 thus eliminating withholding taxes on dividend payments from EU countries (under Directive conditions)
- No CFC rules in Cyprus
- Attractive Double Tax Treaty network, reducing withholding taxes on dividend income
- Very simple and tax efficient exit strategies available
- Rulings from Tax Authorities can be obtained
- Thin spread of income possible for financing and royalty structures
Israel - Pan European Tax Planning (Panel Discussion)
### Summary Panel

#### Israel Outbound Investment into the EU

**Base Case**

**Tax result:**

**In Germany:**
- Income: 100
- CIT @ 40%: (40)
- Distributable profit: 60
- WHT @ 20%: (12)

Total foreign taxes paid: 52

**In Israel:**
- Dividend income (gross amount): 100
- Israeli tax liability @ 31%: (31)
- Foreign tax credit: 31
- Israeli tax: 0
- Excess foreign tax credit: 21

Effective tax rate: 52%

---

PricewaterhouseCoopers
**Israel Outbound Investment into the EU**

**Base Case - Enhancement**

**Tax result:**
- At level of Local Co-
  - Income: 100
  - CIT: (40)
  - Distributable profit: 60
  - WHT: (12)
- Total foreign taxes paid: 52
- In Israel:
  - Dividend Income: 100
  - Israeli tax liability @ 31%: 85.2
  - Foreign tax credit: (85.2)
  - Incremental tax: 0
  - Excess foreign tax credit: 0
- Effective tax rate: 31%

---

**Summary Panel**

- Dividend flow from Israel Co. to German Co. and EU Co.
- 10% WHT on dividends:
  - German Co.
  - EU Co.
- 20% WHT on dividends:
  - High Tax
  - Low tax

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PricewaterhouseCoopers

May 2006
Slide 132
Advantages:

• Reduction of WHT taxes to nil:
  - Dividend distribution between EU Member States: 0% WHT (EU P-S Dir).
  - 0% WHT on distribution from Cyprus under Cypriot domestic law.

• No taxation on dividends received in Cyprus.

• Use of the Cyprus Co as a tax rate “mixer” and enhance ability to use foreign tax credits at level of Israel Co.

• Profits of Cyprus Co. can be re-invested.

• Israeli CFC issues should be considered.
Israel Outbound Investment into the EU
European Holding Company – via the UK

Advantages:
• Reduction of WHT taxes to nil:
  - Dividend distribution between EU Member States: 0% WHT (EU P-S Dir).
  - 0% WHT on distribution from the UK, according UK domestic law.
• Taxation of dividends in the UK – the credit method.
• Profits of UK company can be reinvested.
• a “tax rate mixture” may be applicable in the UK with respect to the received dividend income – however need to coordinate dividend distributions.
• Israeli CFC issues should be considered.
## Israel Outbound Investment into the EU
### European Holding Company – Cyprus vs. UK

<table>
<thead>
<tr>
<th></th>
<th>Base Case</th>
<th>Cyprus Co.</th>
<th>UK Co.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxation of dividend at level of HoldCo</strong></td>
<td>Yes - 25% on amount of dividend received + FTC on foreign WHT, or - 31% on underlying income + FTC for underlying taxes</td>
<td>No</td>
<td>Yes - 30% on underlying income + FTC for underlying taxes</td>
</tr>
<tr>
<td><strong>WHT</strong></td>
<td>Additional cost</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td><strong>Ability to utilize foreign tax credits at Israel Co level</strong></td>
<td>Limited</td>
<td>High flexibility</td>
<td>Low flexibility</td>
</tr>
<tr>
<td><strong>Reinvestment</strong></td>
<td>Inefficient – requires distribution to Israel</td>
<td>Flexibility</td>
<td>Flexibility</td>
</tr>
<tr>
<td><strong>Foreign CFC Regime</strong></td>
<td>N/A</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Foreign Compliance issues</strong></td>
<td>N/A</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>
Israel Outbound Investment into the EU
Operation via EU branches – Cyprus Head office

Advantages:
- Taxation of accumulated profits:
  - Local taxation of branches.
  - Income of branches is exempt in Cyprus.
- Reduction of WHT taxes to nil:
  - 0% WHT on the transfer of profits to Head Office (one legal entity – no distribution).
  - 0% WHT on distribution from Cyprus, under Cypriot domestic law.
- Accumulated EU profits in Cyprus and possible re-investments in the EU.
- Israeli CFC perspective - Business activities of Cyprus Co. are considered active, due to the PE’s (no Israeli CFC).
Israel Outbound Investment into the EU
Operation via EU branches – Dutch Head office

Advantages:
- Taxation of accumulated profits:
  - Local taxation of branches.
  - Branch profits not taxed in NL provided certain conditions are met.
- Reduction of WHT taxes:
  - 0% WHT on the transfer of profits to Head Office (one legal entity – no distribution).
  - 5% WHT on distribution from The Netherlands, under Dutch domestic law.
- Accumulated EU profits in Dutch Co. and possible re-investments in the EU.
- Israeli CFC perspective - Business activities of Dutch Co. are considered active, due to the PE’s (no Israeli CFC).
Israel outbound Investments into the EU
Investment in EU immovable property

Advantages:
- No WHT on Dividends
- Dividends & Cap. Gains exempt in Cyprus
- C. Gains exempt in country where property situated
- Rental income always taxable in country where property situated.
- CY Co profits may be reinvested free of any taxation.
- Three tier structure is used when mom residents cannot hold directly the property and disposal of local company shares is taxable in the country the property is situated.
Financing
German KG

Plan:
- EU branch or partnership.
- Cyprus Co. as general partner or head office finances the branch/partnership indirectly (Cypriote partnership) via Loan.

Tax result:
- Interest deduction @ high tax.
- 0% WHT on interest payment to Cyprus, since no separate legal entity exists in EU.
- Low taxation of interest in Cyprus – 10%.
- 0% WHT upon distribution of dividends to Israel, according to Cypriot domestic law.
- Israeli CFC considerations - Business activities of Cyprus Co. are considered active, due to business activity in Germany (no Israeli CFC rules apply).
Financing
Swiss Equity Financed Finance Company

- Business activity in Germany.
- Equity is transferred to Swiss Co. through Cyprus Co.
- A loan from Swiss Co. to German Co.
- Deductible interest expenses in Germany (high tax), but:
  - Notional interest deduction according to Swiss domestic law – only small portion of interest income is subject to tax.
- Subsequent dividend distribution to Cyprus Co. – dividend exempt in Cyprus.
Financing
Irish Interest-Free Loan with NID

- Interest deduction at OpCo level
- Due to deemed interest deduction Dutch BV only taxable on minimal spread.
- No interest pick-up in Ireland
Financing
Double Malta Structure

- Interest income received by Malta Co B is taxed at 35%.
- Effective tax burden in Malta 4.17% to 6.25% due to imputation/refund mechanism
- Can benefit from Malta Double Tax Treaties and EU Interest and Royalties Directive (if requirements are met)
- No WHT on dividends and interest under Malta domestic law
- Only one jurisdiction, avoids the use of a haven and non EU structures
- No CFC rules in Malta
- No thin capitalization rules in Malta
Financing
Spanish ETVE

- ETVE allowed to amortize financial goodwill on acquisitions of EU and non-EU subsidiaries over 20 years
- Through tax consolidation, goodwill amortization can be offset against Spanish OpCo’s taxable income
- Acquired foreign entities may be group companies
- Interest payments by ETVE on leveraged acquisitions are tax deductible even though income from non-resident subsidiaries is tax exempt
- Through tax consolidation, interest payments of ETVE will offset Spanish OpCo’s taxable income
- No Spanish WHT on interest to EU
Financing
German Partnership Structure: Withholding Tax Planning

- Avoidance of WHT for non-EU investor
- Dividends received by KG are 95% tax exempt but subject to WHT; yet WHT on dividends fully refunded to KG
- Interest on loan deductible in Germany
- No branch profits tax on KG partnership distributions with German anti-treaty shopping rule not kicking in

Diagram:
- Israel Co
- German OpCo 1
- German OpCo 2
- German OpCo 3
- German HoldCo
- Loan
- Acquisition of Target(s)
- Organschaft
- German KG
Financing German Partnership

- Interest paid by ForCo 2 generally tax deductible in ForCo jurisdiction
- Pursuant to German allocation rules, interest deduction also available in Germany as expenses incurred by ForCo 2 for the financing of KG qualify as special item expense (so-called “Sonderbetriebsvermögen II”); deduction at 100% for corporate tax and 50% for trade tax possible, but within German thin cap limits. Tax consolidation of KG loss (due to interest expense) and German OpCo profits achievable by virtue of “Organschaft”
- German CFC provisions should not apply to entirely foreign owned partnerships
- No WHT or branch profits taxes upon partnership distributions from German KG to ForCo 2 under German domestic law
Financing Dutch Coop with German KG

- No German thin cap, therefore no thin capitalization restrictions / limitation of interest deductibility in KG
  Interest on hybrid loan tax deductible in Germany if hybrid loan does not qualify as a partnership between Co-op and BV
- Interest on hybrid loan tax exempt for Dutch fiscal unity under participation exemption at BV level as the debtor (Coop) is a Dutch resident entity
- No WHT on dividends from German OpCos due to German Organschaft regime
- No WHT on profit transfers from German KG to Dutch Coop under German domestic law
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