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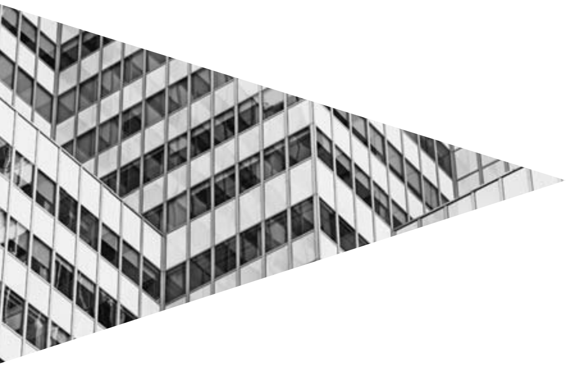
EU direct tax news

A bimonthly review of EU direct tax developments affecting business in Europe



Editorial

Dear Reader,

Is now the right time for greater coordination of national fiscal policies on an EU level? The German chancellor, Miss Merkel, has announced lately the necessity of a stronger harmonized approach in respect of national economies as well as a common tax policy, knowing that there may not be a better time than now for presenting her ideas. The Commissioner, Mr Semeta likewise markets the idea of a harmonized tax base, a proposal for which may be published in the first half of this year. Not surprisingly then, this EU direct tax news focuses on tax policy matters and presents two reports on the likely impact of a Common Consolidated Corporate Tax Base (CCCTB) on Member States and companies.

Dr. Klaus von Brocke

Major developments

Common Consolidated Corporate Tax Base

In the first quarter of 2011, the European Commission (EC) is expected to put forward a proposal for a Common Consolidated Corporate Tax Base (CCCTB) which, if adopted, would provide for a tax system that consolidates the taxable profits of a group of companies under common control. The consolidated tax base would be allocated across the 27 EU Member States on the basis of a three-factor apportionment formula (ie, geographic distribution of sales, labor and assets).

The EC suggests that the benefits of the CCCTB would be a reduced corporate tax compliance burden for groups operating across EU Member States, a reduced number of transfer pricing adjustments between companies based in Member States that have adopted the CCCTB and the cross-border offset of future tax losses within the CCCTB group.

Ernst & Young has been following the developments of the CCCTB with keen interest and working with clients to understand its potential effects. In particular, two Ernst & Young reports have recently been made public.

The findings of the two Ernst & Young reports

The first Ernst & Young report[1] considers the impact of the CCCTB proposals on corporate tax compliance processes, studying and comparing the data provided by five groups of companies with significant European operations.

The study indicates that the CCCTB would lead to a **13% increase in average compliance costs** for these businesses due to the additional costs of preparing and filing the tax return under the CCCTB system. The tax administration costs would outweigh the expected savings from a potentially reduced need for transfer pricing adjustments. Businesses are also expected to incur substantial one-off costs in the transition to a new system.

The study found that the majority of companies would see the **effective corporate tax rate increase** under the CCCTB. The apportionment rules would mean that a higher share of company income would be apportioned to the larger Member States and would be subject to higher corporate tax rates.

The proposed CCCTB **apportionment mechanism was seen to be distortive** and did not reflect the underlying economics of modern business. In particular, the lack of recognition of intellectual property and entrepreneurial risk may result in potentially large differences

[1] *http://www.ibec.ie/IBEC/DFB.nsf/vPages/Economics_and_taxation~Key_issues~common-consolidated-corporate-tax-base-(ccctb)-07-02-2011?OpenDocument&SK=T*

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between the location of taxable profit under the current country level regimes and the CCCTB. This would likely create many distortions and would mean that tax may become an impediment to business transactions, possibly to the detriment of the EU as a business location.

The flexibility to opt in and out of the regime has been considered a key attribute to make the CCCTB proposal attractive for businesses. However, the groups participating in the study commented that the existence of an **option to enter or leave** the regime every three years would either be **impractical** or would require the running of parallel systems to enable the groups to switch between the systems.

The second Ernst & Young report[2] considers the potential economic and fiscal effects of the CCCTB proposal. In particular, the report estimates the change in taxes in each EU Member State if the CCCTB were adopted. The estimates are based on the analysis of income and balance sheet data of over 50,000 groups, then allocating the estimated consolidated income to EU Member States using the three factor formula proposed by the EC (sales, labour and assets).

The Ernst & Young study finds **significant winners and losers** (among both taxpayers and countries) if a CCCTB is adopted:

- While some CCCTB proposals would be close to revenue neutral, substantial changes in country-by-country tax collections would occur. Figure 1 shows that five countries would lose at least 5% of their revenues (Denmark, Netherlands, Ireland, Germany, and Finland), while 10 countries would gain revenues. The largest loser is Denmark (-8.3%); the largest winner is France (+6.0%).

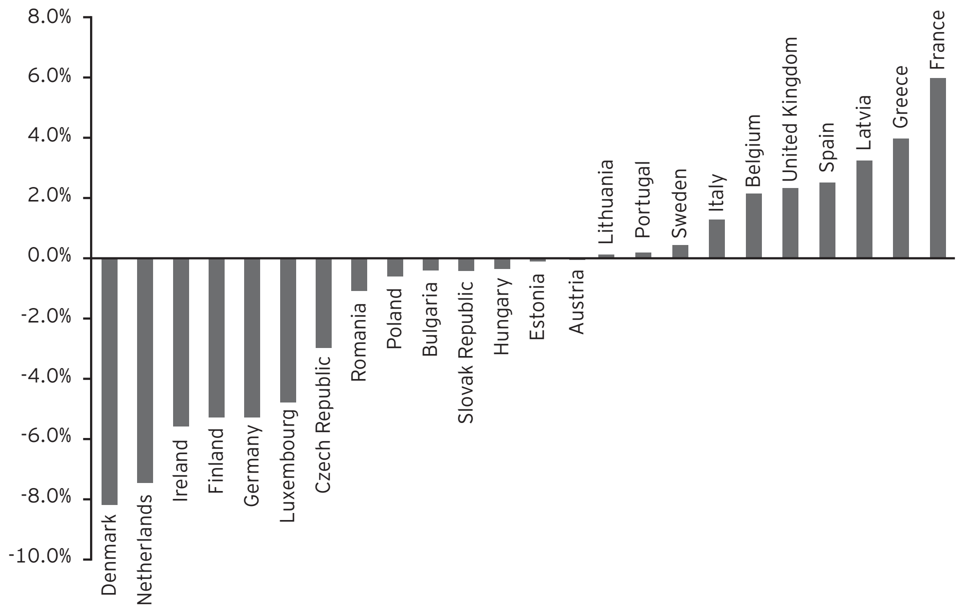

Figure 1: Static revenue impact of a mandatory CCCTB, 27 participating Member States

[2] *http://www.finance.gov.ie/viewdoc.asp?m=&DocID=-1&CatID=62*

- Figure 2 presents the projected changes in employment across countries under the CCCTB system. Belgium, Spain and France would gain jobs; France would have the highest increase at 0.5%. The remaining countries would have decreases with Ireland, Luxembourg, and Poland all experiencing job losses of at least 1.0%.

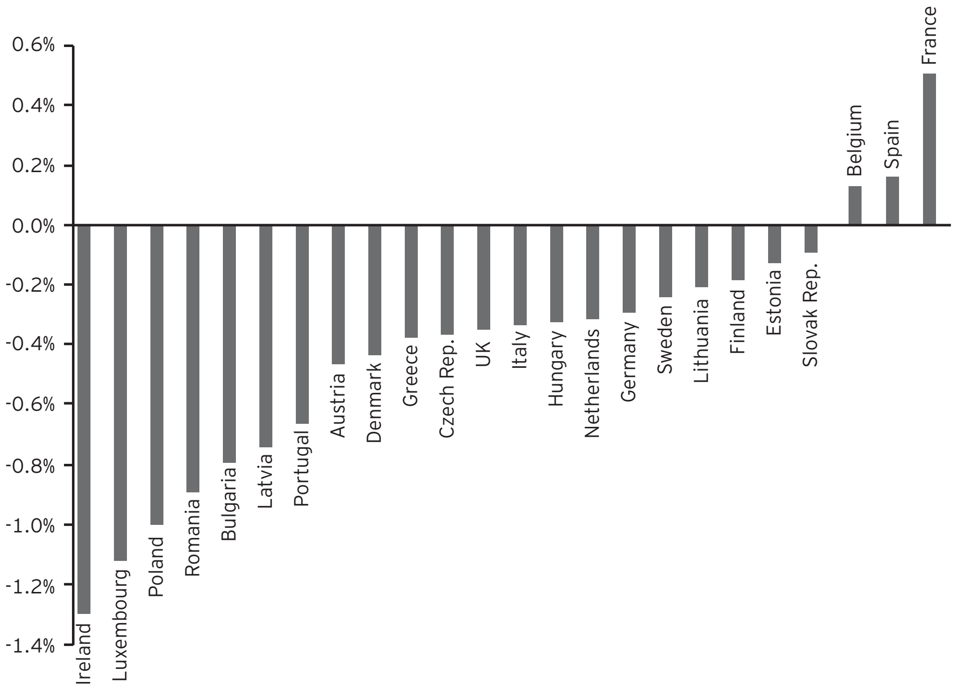

Figure 2: Percent change in employment for 27 Member States under mandatory CCCTB due to changes in effective tax rates

- The Study also shows that adopting the CCCTB would have larger negative impacts on foreign direct investment (FDI). Seven countries would experience FDI reductions of more than 4%.

Focus on

European Commission: Tax policy outlook for 2011 and beyond

Steve Bill | EY Tax Policy Group | EU United Kingdom

With the new European Commission executive completing their first full year, a clearer picture of direction of taxation policy is now emerging. Four key taxation themes which have emerged as policy cornerstones, along with the continued focus on taxation of the financial sector and improving the exchange of information among Member States will form the focus of 2011 and beyond.

After the first full year of office of Algirdas Šemetat, the new Commissioner for Taxation and the Customs Union of European Commission, we now have a clear picture of the direction in which taxation policy is heading under his guidance.

Mr Šemeta's policy does not deviate significantly from that pursued by his predecessor, Lazlo Kovacs. However, under Mr Kovacs, the main thrust of tax policy was portrayed as supporting the Lisbon Growth and Jobs Strategy (see the Communication on The Contribution of Taxation and Customs Policies to the Lisbon Strategy – COM (2005)532[3]). Under Mr Šemeta Lisbon Growth and Jobs Strategy has become an important element in the relaunch of the single market which in turn is an essential component of the European Union (EU) 2020 strategy for "smart, sustainable and inclusive growth".

Four key taxation initiatives

Thus the recent Commission Communication "Towards a Single Market Act" (COM (2010) 608 of 11 November 2010[4]) includes four taxation initiatives, three of which are at the heart of Mr Šemeta's drive to reduce compliance costs and administrative burdens for business. This would have been unimaginable under the previous Irish Internal Market Commissioner, Charlie McCreevy, who was implacably opposed to many of the ideas for EU policy action in the field of taxation, and reflects the fact that the new French Internal Market Commissioner, Michel Barnier, is far more sympathetic towards taxation initiatives.

Common Consolidated Corporate Tax Base: let's try again?

This is particularly the case with regard to the first of these initiatives, the CCCTB. The preparatory work for this proposal started almost ten years ago and was finalised under Mr Kovacs. Mr Šemeta is now proposing the tabling of a draft directive in 2011, with the goal of reducing the tax obstacles which result from the existence of 27 different corporate tax systems in the EU. This is a highly ambitious project which, by offering businesses the possibility of using one single consolidated corporate tax base for all their EU activities and profits, may potentially reduce the administrative costs for companies already operating across Europe and encourage cross-border expansion within the internal market by:

- Intra-group transfer pricing compliance obligations
- Possible instances of double taxation arising from inconsistent national rules
- Allowing EU wide losses to be offset in one consolidated group return
- Providing the possibility to deal with one single tax administration

However, the advantages for business are regarded by some Member States as potential threats to their revenue base, and unless the wider benefits of tackling fiscal impediments to growth prevail, it is difficult to see how unanimity will be reached once this proposal reaches the European Council for approval. Moreover, given that this will undoubtedly be a large and complex legislative proposal, it will be a subject of detailed discussion which is likely to last for several years.

[3] *http://europa.eu/legislation_summaries/customs/l11027_en.htm*

[4] *http://ec.europa.eu/internal_market/smact/index_en.htm*

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Thus although Mr Šemeta may well succeed in having a proposal adopted by the Commission in 2011, it is unlikely that it will be endorsed by the Council before the end of this Commission's five year mandate.

Reforming VAT

The second area which Mr Šemeta intends to prioritize is a thorough review of the EU's VAT system. The recent Green Paper on the Future of VAT (COM (2010) 695[5]), published on 1 December 2010, has started this process. It brings together two disparate strands which have been extensively debated over the last decade – the need to modernize and simplify the EU's common VAT system, in order to reduce the administrative burdens it poses for businesses operating in more than one Member State, and the need to help Member States combat fraudsters who exploit weaknesses in the control of intra-community movements.

Interested parties have been invited to submit comments by May 2011 on a wide range of issues which are divided into two major categories – what should be done about the intra- community system as a whole and what needs to be done irrespective of the changes which might or might not be made to the system? The Commission then intends to present a Communication setting out the areas that the Green Paper debate highlights as priorities for action followed by appropriate legislative proposals.

There is no doubt that, as a whole, Member States are more receptive to the need for action in this area, not least because there is already a substantial body of EU law in existence. By contrast, the concrete results of the previous Strategy launched in 2000 to simplify and modernize the VAT system were disappointing and it will be interesting to see whether more consensus can be achieved this time.

[5] *http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/future_vat/com(2010)695_en.pdf*

Tackling double taxation

The third issue which has been prioritized is the need to tackle instances of double taxation in the single market. The Commission's recent public consultation has identified a wide range of problems which need to be addressed, affecting both businesses and private individuals who either work, live, retire, invest or buy property in other Member States. These include, among others, the divergent taxation of pensions, differing treatment of venture capital funds investing across borders and conflicts regarding tax residence. The importance of this initiative is that it shows that the Commission is not only concerned with improving the functioning of the Internal Market for business.

A Communication will set out the Commission's views on how these problems can be tackled and again, is intended to be followed by specific proposals. This is an area where the Commission may well seek to further develop a "co-ordinated" rather than "harmonised" approach and thus reduce opposition from those Member States who do not readily accept EU competence in the field of direct taxation.

Energy taxation on the table

Another priority will be to carry out a revision of the Energy Taxation Directive which, like the CCCTB, was at the heart of Mr Kovacs' tax policy. The intention will be to modify the current EU taxation framework so that it will become more compatible with the EU's energy and climate change policies and thus support the sustainable growth objectives of the Europe 2020 strategy.

The essence of the reform will be to move the taxation of energy away from the traditional approach of taxing the quantity of fuel consumed and towards the taxation of energy content and CO2 emissions. This is an approach which has already been pursued by some Member States but they have encountered problems in particular because of conflicts with the EU's Emissions Trading Scheme. A proposal is expected in 2011.

Focus on

European Commission: tax policy outlook for 2011 and beyond

Taxing the financial sector

In addition to these four major initiatives, the Commission recently announced in its October Communication on the Taxation of the Financial Sector (COM (2010) 549) the intention to carry out a detailed impact assessment of the consequences of introducing a Financial Activities Tax (FAT) at the EU level and has undertaken "to make appropriate proposals on policy actions by summer 2011". The Commission's action in this area has been more in the nature of a response to vague but insistent demands from the Council than an indication of enthusiasm for a new harmonised tax at Community level. Indeed the largely un-coordinated way in which several Member States have introduced – and in the case of the UK, recently increased - bank levies does not suggest agreement on harmonised action in respect of a FAT.

Rounding out the policy picture

Finally, there are two other areas where Mr Šemeta has signalled his intention to be active. The first is the idea of discussing with Member States the "quality" of current tax systems both to identify distortions that could possibly have exacerbated the recent financial crisis and reforms which could underpin sustainable growth. To this end, he has re-launched the Tax Policy Group composed of personal representatives of EU Finance Ministers as a forum for political discussion.

The second is the continued commitment to ensure good governance in the tax area. This will involve further action to fight fraud and evasion within the EU, and to contribute to the campaign for good governance both within the EU and beyond by promoting the principles of transparency, tax information exchange, and fair tax competition through instruments such as the Code of Conduct Group and the Savings Directive.

We have already seen early action in this regard, with the 7 December 2010 announcement that the Council of the European Union reached political agreement on the content of the February 2009 draft Directive 'Administrative cooperation in the field of taxation'. With this directive effectively delivering a complete overhaul of the 1977 Directive 1977/799/EEC, it contains a number of measures of significance, including coverage of all taxes except those that are dealt with by separate EU legislation (for example, the VAT Directive), measures allowing the tax authorities of the Member State to make administrative enquiries in the territory of another Member State, and the provision of far more stringent restrictions on bank secrecy. In that regard, a Member State will no longer be able to refuse an information request regarding taxpayers solely on the basis of bank secrecy. In addition to these measures, Member States are also held to provide the same level of cooperation to any other Member State as they have agreed to with any third country (the 'most favored nation' principle). Therefore, an agreement with a third country implies a commitment to all the other Member States of the EU for the same level of cooperation.

If all that has been promised by the Commission is duly delivered, then 2011 will be a very active year for EU tax policymakers. However, as always, the difficulty of getting Member States to reconcile their overriding concern with fiscal sovereignty with the more intangible goals of co-ordinating or harmonising their tax systems to improve the functioning of the Internal Market and foster sustainable growth will mean that the Commission is likely to face its usual uphill battle to see its ambitious proposals adopted by the Council.

Direct tax

Country updates

Austria

Judgment of the Court in joined cases *Haribo* and *Österreichische Salinen*

On 10 February 2011 the Court of Justice (CJ) delivered its judgment on the joined cases *Haribo* (C-436/08) and *Österreichische Salinen* (C-437/08). Both cases concern the treatment of inbound portfolio dividends, i.e. dividends from participations of less than 10% in non-Austrian subsidiaries.

Facts of the joined cases

Haribo received portfolio dividends from EU and third country participations. Portfolio dividends from Austrian and EU participations are exempt from tax (assuming sufficient taxation in case of EU dividends). In contrast, the exemption of European Economic Area (EEA) portfolio dividends is subject to availability of mutual administrative and enforcement assistance. Furthermore, the taxpayer is required to provide the information that is necessary for the application of the tax exemption. If those requirements are not met the dividends are taxed and any underlying tax imposed in the country of the distributing company – limited to the amount of the Austrian tax – would be credited against the Austrian tax (credit method). Portfolio dividends from third (non-EEA) countries are always subject to tax in Austria.

Mutual administrative and enforcement assistance

Dividends from portfolio participations in EEA countries are exempt from corporate income tax only if a comprehensive agreement for mutual assistance with regard to administrative matters and enforcement between Austria and the respective EEA country exists. According to the Court, it is allowed to require mutual administrative assistance in relation EEA countries. In contrast, enforcement assistance may not be required.

Equality of methods and administrative burden

The application of the exemption method is subject to the taxpayer providing necessary information for the exemption. If the taxpayer is not able to do so, the credit method would apply. However, the difficulties of the taxpayer in gathering the respective information are also inherent to the credit system. Additional administrative burdens are inherent to the credit method and not as such contrary to the free movement of capital.

Third (non-EEA) country portfolio dividends

Third (non-EEA) country portfolio dividends are neither tax exempt nor subject to a credit of the underlying tax. Those dividends suffer economic double taxation which infringes, according to the Court, Article 63 Treaty on the Functioning of the European Union (TFEU). Therefore, an amendment of the Austrian rules for third country dividends is necessary to grant relief from economic double taxation either by applying the exemption or the credit method. Such relief could be subject to the availability of mutual administrative assistance that is comparable to the assistance provided under the Directive 77/799/EEC (e.g. assistance due to a double tax treaty or a Tax Information Exchange Agreement (TIEA).

Carry-forward of foreign underlying tax credit

In case of a loss situation foreign tax cannot be credited. This leads to economic double taxation if no tax carry-forward is granted. Consequently, Austria has to amend the respective provisions and provide for a carry-forward of foreign underlying tax credit in case of switch-over at foreign portfolio dividends. Correspondingly, a tax carry-forward is likely to be required in case of switch-over at dividends from EU/EEA equity participations. Carry-forward of withholding tax on the dividends was not required by the CJ.

Finland

Finnish Supreme Administrative Court refers a case to CJ regarding exchange of shares within EEA

The case which is now referred to the CJ by Finnish Supreme Administrative Court (KHO 2011:10) concerns a cross-border exchange of shares within the EEA. In this case a Finnish company transfers shares of another Finnish company to a Norwegian company in exchange for new shares issued by the Norwegian company. In its request for a preliminary ruling from the CJ, the Finnish Supreme Administrative Court, considering the Articles 31 (right of establishment) and 40 (free movement of capital) of the EEA Treaty, asks whether this exchange of shares should be treated in a tax neutral manner in the same way as if the exchange of shares concerned domestic companies or companies in EU Member States

According to the Finnish domestic legislation, exchange of shares generally does not trigger any Finnish income tax consequences provided that the parties to the transaction are domestic companies or companies from other EU Member States. The legislation in this respect is based on the EU Merger Directive (2009/133/EC). Contrary to certain other EU Member States, Finland has not extended these rules to parties resident in EEA countries.

It should be noted that the Finnish Central Tax Board has issued a decision in 2007 (KVL 38/2007) in which the cross-border merger of a Finnish company with an Icelandic company (EEA country) was accepted as a tax neutral merger. The Central Tax Board based its decision on the right of establishment under the EU and EEA Treaties. The case was not referred to the Finnish Supreme Administrative Court.

Based on the rulings issued by the CJ in the past concerning EEA countries and considering the principles laid down in the EEA Treaty, it seems reasonable to believe that the exchange of shares involving companies from EEA countries would be treated as tax neutral similar to those involving only domestic or EU companies, especially if the following conditions are met:

- EEA company is comparable to a Finnish corporate entity
- Full administrative assistance is available between Finland and the EEA country and
- There are no justification grounds (such as risk of tax avoidance) which could preclude the applicability of the principles of the EEA Treaty.

However, since there is currently no established accepted legal practice on the matter in Finland, the outcome remains somewhat unclear. Thus, the Finnish Supreme Administrative Court has decided to refer this case to the CJ to clarify the interpretation of the Articles 31 (right of establishment) and 40 of EEA Treaty to the case at hand.

France

Advocate General's opinion in the *Accor* case relating to the French "*avoir fiscal*" and "*précompte mobilier*" mechanism

On 22 December 2010, the Advocate General released his opinion in the *Accor* case (C-310/09), which relates to the French *avoir fiscal* and *précompte mobilier* mechanism.

For French parent companies benefiting from the participation exemption regime, the *avoir fiscal* (fiscal credit) attached to French-sourced dividends could be offset against the equalization tax due on the redistribution of exempt income (so-called *précompte mobilier*). In contrast, since EU-sourced dividends did not benefit from the *avoir fiscal*, French parent companies receiving EU-sourced dividends could not offset it against the equalization tax due. Since the *avoir fiscal* and the *précompte mobilier* have been abolished by the French Finance Law in 2004, French companies have contested for previous years the payment of equalization tax for EU-sourced dividends on the grounds of the EC freedoms and the Parent-Subsidiary Directive (PSD).

France

The French Administrative Supreme Court decided to refer several questions to the CJ:

- Is the "*précompte*" mechanism contrary to the free movement of capital?
- If so, may the French tax administration refuse to refund the "*précompte*" paid by the parent company on the grounds that such refund would constitute an unjust enrichment?
- Do the principles of equivalence and efficiency prevent the French tax administration from requiring the parent company to justify the amount of corporation tax paid by its EU subsidiaries, where such justification is not required for French subsidiaries?

Answering the first question, the Advocate General held that the "*précompte*" mechanism had a restrictive effect at the level of the parent company and should thus be regarded as contrary to the free movement of capital.

Answering the second question, relating to the amount of proof to be provided by the parent company in order to evidence the tax borne by its foreign subsidiaries, the Advocate General held that, in case the *avoir fiscal* and *précompte mobilier* mechanism took into account the tax effectively paid by the French subsidiary on its distributed profits (position defended by the French tax authorities), the tax authorities might request the parent company to evidence the amount of tax borne by the foreign subsidiaries, except where such evidence would be impossible or excessively difficult to provide in regards, notably, to the rules on conservation of legal documentation existing in the countries of establishment of the subsidiaries.

Answering the third question, whether or not refunding the *précompte* to the parent company would constitute an unjust enrichment, thus authorizing the French tax authorities not to proceed with the refund, the Advocate General considered that the unjust enrichment, classically used as legal principle by the CJ in indirect tax cases, may be extended to situations where the claimant had not borne the economical cost of the tax paid.

Based on such analysis, it would thus not matter that the parent company was legally liable to pay the *précompte*: only parent companies which had effectively economically borne this tax would be entitled to a refund. As a consequence, where the *précompte* had not been offset against the dividends distributed by the parent company (i.e., all the dividends received from foreign subsidiaries have been distributed by the parent company to its shareholders), the parent company has effectively borne the economical cost of the tax and the unjust enrichment exception would not apply.

However, the Advocate General proposed another solution, applying to the case at hand, the FII Group Litigation decision (C-446/04):

- Where the *précompte* was not offset against the dividends, the parent company should not be entitled to a refund since the losses suffered by the parent company "*would not be the unavoidable consequence of the refusal of France to pay the avoir fiscal in conditions analogous to the situation where a French parent company received dividends from French subsidiaries*"
- Where the *précompte* was offset against the dividends, the parent company would be entitled to request the refund, in proportion to the economical loss suffered by the parent company

The proposed solution raises several questions.

In the *FII Group Litigation* decision, the CJ held that companies, which have increased the amount of dividends distributed in order to compensate their shareholders' inability to benefit from a tax credit, might not file a refund claim but should instead file a damages claim. Is this decision relevant in the case at hand? Is the situation where a company compensates for a tax that the company is liable to pay comparable to the situation where a company compensates for a tax credit that its shareholders may not benefit from?

Whereas the *FII Group Litigation* decision provided a clear picture of the legal actions available to the parent company and its shareholders, based on the person who may legally benefit from the tax credit, the solution in the *Accor* case might lead to denying the right to claim for a refund to both the parent company, since the company decided to bear the tax, and the shareholders, since they did not bear the tax.

Finally, in order to ensure a clear meaning of the law and legal certainty, would it not be preferable to determine distinct legal criteria in respect of: Who is liable to the tax? Who is entitled to its refund under the applicable tax law? It would then be for the parent companies and their shareholders to agree on the sharing of the refunded *précompte*.

Does the 3% tax on French immovable property held by a BVI company infringe the free movement of capital principle?

Pursuant to Section 990 D of the French Tax Code, companies which directly or indirectly hold immovable properties in France are subject to an annual tax of 3% on the market value of the properties. However, former Section 990 E provided that the tax is not due by companies whose effective place of management is in France, and foreign companies whose effective place of management is in a country which entered with France into a double tax treaty including a mutual assistance clause or a non-discrimination clause based on nationality.

In the *Elisa* case (C-451/05), which relates to a French immovable property held by a Luxembourg 1929 holding, the CJ decided on 11 October 2007 that these provisions were contrary to the free movement of capital (Article 63 of the TFEU).

In the *Etablissements Rimbaud* case (C-72/09), which relates to a French immovable property held by a Liechtenstein company, the CJ decided on 28 October 2010 that these provisions, while restricting the free movement of capital (Article 40 of the EEA Agreement), were justified by the fight against tax evasion and the need to safeguard the effectiveness of fiscal supervision.

After Luxembourg and Liechtenstein, the Lower Administrative Court of Paris referred to the CJ a case where the immovable property was held indirectly by a company located in the British Virgin Islands, which are neither a Member State, nor a third country but an "Overseas Country and Territory" (OCT) subject to the specific rules laid down in Article 198 et seq. of the TFEU (C-OCT-384/09 – Prunus SARL).

In his opinion released on 9 December 2010, the Advocate General concluded that the free movement of capital set out in Article 63 TFEU applied to OCT. The Advocate General thus rejected the argument according to which situations involving OCTs are only covered by the specific provisions of the TFEU and the decisions 91/482/EEC and 2001/822/EC on the association of the OCTs with the European Union.

Concerning the standstill clause contained in Article 64 TFEU, which allows Member States to maintain provisions infringing the free movement of capital in respect of direct investments from third countries, where these provisions existed prior to 31 December 1993, the Advocate General held that this clause did not apply to OCTs since "*they are not States in the strict sense and that they have a status which is specifically protected by the Treaty*" and "*the extension of Article 64 to OCTs is contrary to the objectives pursued by the Treaty in conferring on those territories a special political, economic and social relationship with the Union*".

However, applying the principles set out by the CJ in the *Elisa* and *Etablissements Rimbaud* cases, the Advocate General considered that, while the 3% tax levied on French immovable property held by a BVI company constituted a restriction to the free movement of capital, such restriction was justified by the fight against tax evasion, since:

France

- The 1977 directive on mutual assistance in direct and indirect taxation between Member States was not applicable in the case at hand
- There is no accounting harmonization between the Member States and the BVI
- There are no mechanisms allowing a mutual assistance on tax matters between the Member States and the BVI

Germany

Advocate General's opinion in *Meilicke II*: German Provisions on the taxation of dividends (C-292/04) applicable prior to tax year 2001
On 13 January 2011, Advocate General (AG) Verica Trstenjak rendered her final opinion to the request of the Lower Tax Court Cologne for a preliminary ruling in the case.

The AG held the view that the crediting of foreign corporation tax on EU-foreign dividends against German income tax has to be granted only up to the level of the German corporation tax rate on domestic dividends and that it is not always necessary to give evidence of the foreign tax charge by way of a corporation tax certificate as requested under German law. However, she accentuated that the burden of proof for the amount of foreign corporation tax paid is with the taxpayer. In the light of the current stance on the harmonization of Community Law, the principle of effectiveness and the principle of equivalence cannot be understood as meaning that national courts must estimate this amount if the taxpayer is not able to determine the foreign corporation tax charged, provided that in a similar domestic case the courts would also not be required to estimate the tax credit.

Background
On 6 March 2007, the CJ gave its long-awaited decision in the *Meilicke I* case after the rendering of two opinions of different AGs. In its fact pattern and merits, the case resembles the Finnish case *Manninen* (C-319/02). The CJ largely agreed with both AGs and held that the German provisions on the taxation of dividends are inconsistent with the EC Treaty. Such national legislation, under which a fully taxable shareholder is only entitled to a tax credit calculated by reference to the corporation tax rate on distributed profits if the dividend paying company is a domestic company, is precluded by Articles 56 and 58 EC Treaty. Such rules could deter persons who are fully taxable in Germany from investing abroad on the one hand, and constitute an obstacle to foreign companies to raise capital in Germany on the other.

In July 2009, the Lower Tax Court of Cologne filed a request with the CJ for a second preliminary ruling, largely requesting more detail on how the guidelines of the CJ's decision of 6 March 2007 should be legally applied. While the statements of the CJ in this decision brought clarity about the rules that have to be applied in this prior case, the CJ is now confronted with the problem that the corporation tax charged on dividends received from a company resident in another EU country than where they are actually paid is in practice difficult to determine. In particular, the referring court is uncertain about how and under consideration of which procedural rules the tax credit has to be made.

Questions referred

The Lower Tax Court Cologne referred the following questions to the CJ:

1. Is it in accordance with Community Law that the tax credit on EU-foreign dividends will be the same percentage of the dividend as the German tax credit on German dividends i.e., 3/7 of the gross dividend, if the foreign corporation tax charged, and respectively actually paid, is in practice impossible to determine and could be even higher than the corporation tax charged on dividends received from domestic companies?
2. Does Community Law preclude legislation that the foreign tax credit on EU-foreign dividends requires the submission of a corporation tax certificate, which must contain, inter alia, the amount of corporation tax deductible and the composition of the

Germany

payment under the various parts of the capital and reserves available for distribution on the basis of a special division of capital and reserves under German tax law? It is in practice impossible to determine the foreign corporation tax actually paid that is to be set off.

3. Does the free movement of capital require that the amount of the charge to corporation tax should be estimated and, if appropriate, at the same time indirect prior charges to corporation tax should be taken into account? This applies in case where it is actually impossible to submit a corporation tax certificate and, in the absence of being able to determine the corporation tax charged on the foreign dividends which was actually paid.

4. (a) In case a corporation tax certificate is required, the court asks if the principle of effectiveness and the principle of protection of confidence preclude national legislation under which, from 29 October 2004, without any transitional period for the purposes of claiming credit for foreign corporation tax, the submission of a corporation tax certificate is no longer deemed to be an event with retroactive effect, as a result of which it is made procedurally impossible to set off foreign corporation tax where income tax assessments have become final before that date?

4. (b) In case no corporation tax certificate is required, the referring court asks if Community Law should be understood to preclude legislation under which a tax assessment notice must be amended provided that an event with retroactive effect occurs, such as the submission of a corporate tax certificate, and consequently a corporation tax credit is possible in relation to domestic dividends even where income tax assessments have become final, whereas this would not be possible in relation to foreign dividends for want of a corporation tax certificate?

AG Trstenjak's opinion

According to AG Trstenjak the CJ should answer the questions referred by the Finance Court Cologne as follows:

- **Foreign tax credit should be limited to the lower of foreign taxes charged and tax credit applicable on German dividends.** According to the Free Movement of Capital (Article 56 EC Treaty), tax credit of corporation tax on EU-foreign dividends against German income tax has to be granted up to the amount of the German tax credit on domestic dividends, but is limited to the effective foreign corporation tax charged. As far as indirect corporate tax charges on domestic dividends have an influence on the tax credit granted to the recipient, indirect corporate tax charges must also be taken into consideration for the calculation of the tax credit granted on EU-foreign dividends.
- **German corporation tax certificate should not be required** National legislation that makes the submission of a corporation tax certificate a necessary requirement for the credit of the corporation tax violates the principle of effectiveness if evidence of a tax credit becomes difficult or impossible due to this constraint. The referring court is responsible for determining if such a violation exists in the case at hand.
- **Community Law itself should not require an estimation of the foreign tax credit by the local court** As the procedural regulations are principally in the competence of the Member States, it is their responsibility to decide which party has to give evidence of the foreign corporation tax paid. In this context, the Community Law principles of effectiveness and equivalence have to be adhered to. However, the principle of effectiveness does not require an estimation of the foreign tax credit by the National Court if the actual corporation tax paid can no longer be determined. The principle of equivalence requires an estimation only, if the court would also be obliged for such an estimation in a similar domestic situation.

Germany

- **Amendment of final tax assessments should not require the submission of a corporation tax certificate** The principle of effectiveness precludes legislation under which a final income tax assessment can be amended retroactively by the submission of a corporation tax certificate, if such certificate can, in practice, only be obtained for dividend payments of domestic corporations. The referring court is responsible for determining if such a violation exists in the case at hand.
- **A transitional period for the change of procedural law should be required.** The principle of effectiveness and the principle of protection of confidence preclude the national legislator from abolishing a provision which allows the amendment of a final income tax assessment under the requirement of a submission of a corporation tax certificate without any transitional period, as a result of which it is made procedurally impossible to offset foreign corporation tax where income tax has become final from that date. A transitional period of at least 12 months has to be granted for the submission of valid evidence for the purpose of corporation tax credit and the amendment of a final income tax assessment notice.

EU Commission qualifies German insolvency restructuring exception in change of ownership rules as unlawful state aid

In July 2009, the German legislators finalized an amendment to the German change in ownership rules, Sec. 8c (1a) Corporate Income Tax Act (CITA). Pursuant to Sec. 8c CITA, any greater than 25 % indirect or direct ownership change in a German or foreign corporation with a German loss carry forward (NOL) to a new owner within a period of five years results in the prorated forfeiture of the NOL. Any greater than 50 % ownership change results in the forfeiture of the entire NOL. The 2009 amendment to Sec. 8c CITA provided for an insolvency restructuring exception. On 26 January 2011, the EU Commission released its decision to disqualify the insolvency restructuring exception as unlawful state aid.

Background

Under the 2009 insolvency restructuring exception, a change in ownership does not result in a forfeiture of a loss carry forward, if the transfer of shares in a loss corporation is part of a plan to rescue the loss corporation.

The acquisition of the shares must take place with the purpose of rescuing the business of the company. A rescue is defined as a measure, which is intended to remove or prevent the insolvency or over- indebtedness of the company and maintains the "structural integrity" of the loss corporation's business.

A preservation of the structural integrity of a business requires any of the following conditions to be fulfilled

- There is an agreement with the German worker's council of the loss corporation on the preservation of jobs, and such agreement has been honoured
- The company continues to pay a total amount of gross salaries over a period of five years following the change in ownership which equals at least 400 % of the average annually paid gross salaries in the five years preceding the ownership change
- The shareholders make significant contributions to the equity of the loss corporation, which equal at least 25 % of the gross assets shown on the tax balance sheet of the loss company at the close of the year preceding the ownership change. The contributions must take place within 12 months following the ownership change, and any distribution made within the following three years will reduce a qualifying contribution accordingly (with the result that the rule will not apply if the 25 % contribution threshold is not reached as a result of this adjustment).

The insolvency restructuring exception does not apply in any of the following cases

- The loss corporation's business was already shut down at the time of the share transfer
- During a period of five years following the share transfer, the loss corporation discontinues its historic business and engages in a different business sector

Direct tax

Country updates

Germany

The insolvency restructuring exception was initially accompanied with a rule that the provision will terminate at 1 January 2010 which rule was, however, eliminated by the legislator in late 2009.

EU Commission Procedure
In February 2010, the EU Commission initiated an infringement procedure against Germany in relation to the insolvency restructuring exception, with the objective to investigate whether or not the measure had to be disqualified as unlawful state aid. In reaction to this, the German Ministry of Finance published a release on 30 April 2010 which instructed the tax authorities to abstain from applying the insolvency restructuring exception in Sec. 8c (1a) CITA until a decision by the Commission on the matter was reached, even if a binding ruling had been granted in relation to the applicability of the rule.

Upon completion of its review, the Commission issued its decision to disqualify Sec. 8c (1a) CITA as unlawful state aid on 26 January 2011. In its ruling, the Commission notes that the German change in ownership rule was established as a general principle in German tax law, which subjects loss carry forwards of all corporations to forfeiture if a change in the ownership structure occurs. Given this, in the view of the Commission, the insolvency restructuring exception amounts to a financial state aided benefit to distressed loss companies, due to the fact that such a benefit would be not available to a financially sound enterprise in a change in ownership transaction. Consequently, the rule would distort entrepreneurial competition within the EU. The German argument that Sec. 8c (1a) CITA should be seen as a permissible exception rule as typically found in tax legislation was rejected. The state aid benefit was determined as unlawful, as it was not conferred within the regulated EU framework of state aid subsidy approval for distressed enterprises.

As a result of this decision, any tax benefit obtained through the application of Sec.8c (1a) CITA would need to be repaid by a recipient. Germany was asked to provide the Commission with a list of all potential aid recipients and information concerning the total amount of the state aid to be repaid, within two months.

The German Finance Ministry is currently deciding whether to litigate the issue before the CJ. Independently of that possibility, a corporation affected by the ruling with sufficient legal standing may litigate the issue at the CJ's Court of First Instance.

Greece

New provisions are soon to be introduced in the Greek tax legislation, with an EU-wide interest, which:

- Aim to enhance the international administrative cooperation with respect to direct taxation issues, via promoting the exchange of information and mutual assistance in the context of international treaties, as well as adapting domestic law to the EU Directive on mutual assistance
- Amend the income tax regime of Greek corporations and limited liability companies.
  Specifically, Law 3842/2010 introduced two corporate income tax (CIT) rates for the taxation of profits of Greek companies depending on whether these profits are distributed ,i.e., 40% or retained (then 24%), rendering thus the EU PSD inapplicable. Seeking to redress this situation, the envisaged regime provides that (a) For the fiscal year ending on 31 December 2010 the CIT rate will be 24% and the corresponding dividends will be subject to 21% withholding taxation (b) For fiscal year starting on 01 January 2011 onwards, the CIT rate will be 20% and the dividends will be subject to 25% withholding taxation. As a consequence, the EU PSD will henceforth fully apply.

Greece

- Introduce the "participation exemption" system in the Greek legislation, since dividends distributed to Greek companies by companies established within the EU will be exempt from taxation, insofar as these are not further distributed.

There are certain tax issues which remain unclear under the Draft Law and which concern:

- The taxation of profits of the Greek branches of foreign companies; in particular, it is not specified whether these shall continue to be subject to the 40% CIT on the profits they export to their respective Head Office, or if the contemplated rules shall apply to them as well. Should this not be the case, then the Greek tax provisions in question would be in breach of the freedom of establishment, as they would allow a difference in treatment between Greek branches of foreign entities and Greek companies established in Greece, precluded by the TFEU according to the CJ in *Royal Bank of Scotland plc*, C-311/97.
- The exact conditions for the application of the aforementioned "participation exemption"; specifically, it is not determined whether this exemption will be granted subject to the fulfillment of the conditions laid down in the EU PSD, It is also not determined if it will also apply to cases where the participation percentage in the EU subsidiary is lower than 10% or held for less than two consecutive years by the Greek parent company.

Luxembourg

Investment tax credit for corporations and Luxembourg permanent establishments of foreign corporations

On 8 June 2010, the Luxembourg Administrative Court referred a case to the CJ regarding the investment tax credit granted to Luxembourg resident companies and Luxembourg permanent establishments of non-resident companies in relation to their investments in certain qualifying assets (for prior coverage, see *EU Direct Tax Newsletter of September-October 2010*).

Under Luxembourg tax law, the qualifying assets need to remain located in Luxembourg and be physically used in Luxembourg. The CJ had to decide whether denying the benefit of the Luxembourg investment tax credit in relation to assets that are not located and used in Luxembourg is contrary to the principle of freedom to provide services within the EU (Article 56 TFEU) and the principle of free movement of capital within the EU (Article 63 TFEU).

On 22 December 2010, the CJ rendered its decision in *Tankreederei I* case, C-287/10 in favor of the tax payer. According to the CJ, the Luxembourg tax law regarding the investment tax credit grants a less favorable treatment to assets located and used in another EU Member State than assets located and used in Luxembourg. Pursuant to Article 56 TFEU, the legislation of EU Member States cannot discourage an EU-resident to provide services in another Member State. According to the CJ, the current wording of the Luxembourg tax law regarding investment tax credits is infringing the principle of freedom to provide services within the EU since it is discouraging Luxembourg companies or Luxembourg permanent establishment of non-resident companies to provide services through assets located in EU Member States other than Luxembourg.

Transposition of the Undertakings for Collective Investment in Transferable Securities Directive (UCITS) IV in Luxembourg tax law

On 17 December 2010 the Luxembourg Parliament voted in favor of the law implementing the "UCITS IV" Directive (2009/65/CE). Luxembourg is the first country of the EU to implement the provisions of the "UCITS IV" Directive in its national law. From 1 January 2011, a new tax regime applies to certain Luxembourg investment funds.

Luxembourg

The following entities will be fully exempt from the 0.5% subscription tax as from 1 January 2011:

- Exchange Traded Funds (ETF): foreign Undertakings for Collective Investments (UCIs) (or individual compartments of umbrella funds) whose securities are listed on at least one stock exchange or any other regulated market recognized, are open to the public and having the exclusive purpose of tracking index performances
- Microfinance Funds structured as UCIs and Specialized Investment funds (SIF) and compartments of Umbrella funds (both UCIs and SIF) of which the investment policy provides that at least 50% of their assets are invested in Microfinance institutions

Capital gains realized by non-resident investors on the disposal of shares of Luxembourg UCIs in the legal form of a corporation are fully exempt from Luxembourg Income Tax as from 1 January 2011. Also, UCIs managed or administered in Luxembourg are fully exempt from CIT, municipal business tax and net worth tax as from 1 January 2011.

Netherlands

Final decision by the Dutch Supreme Court in *X Holding* regarding cross-border fiscal unity
On 7 January 2011, the Dutch Supreme Court issued its final decision in the case *X Holding*. In this case, the question was whether the Netherlands should allow a cross-border fiscal unity between a Dutch parent and its Belgium subsidiary on the basis of the freedom of establishment as guaranteed by the TFEU. On 25 February 2011, the CJ answered this question in the negative. The CJ recognized the fact that the companies' profits and losses may not directly be offset against each other, constitutes a restriction of the freedom of establishment. However, the Dutch fiscal unity regime could be justified by the argument of safeguarding the balanced allocation of the power to impose taxes between the Member States. The Dutch fiscal unity regime was also considered proportionate.

After the case was referred back to the Dutch Supreme Court, the taxpayer argued before the Dutch Court that the Dutch fiscal unity regime should be assessed in the light of the freedom of establishment for each single benefit provided by that regime rather than on an overall basis. The Dutch Supreme Court, however, rejected the claim. It simply held that in the case at hand, it was justified to refuse a cross-border fiscal unity, based on the CJ's judgment in this case.

Despite the clear judgment of the Dutch Supreme Court, some doubts still exist whether in appropriate circumstances, separate benefits of the Dutch fiscal unity regime should be allowed on the basis of the freedom of establishment. One could think of the case of cross-border consolidation of final losses incurred by a foreign subsidiary. It is expected that questions like this will sooner or later be put forward to the Dutch Courts.

Norway

Norwegian Supreme Court case – Repayment/damages for Norwegian dividend tax levied contrary to the EEA agreement from 1994 to 2002
On 7 December 2010, the Norwegian Supreme Court issued its ruling in the Norwegian test case, *Edquist*. The test case concerned the taxpayer's ability to get repayment or damages for dividend tax levied contrary to the EEA agreement in the period 1994 to 2002. The claims were filed with the court in the period 2005 to 2007.

The taxpayers did not prevail as the Norwegian Supreme Court ruled that the claims were time barred due to the applicability of a six month time-limit for filing a lawsuit under the Norwegian Tax Payment Act. The Supreme Court decision provides direction for approximately 100 cases which are pending before the Oslo District Court.

In 2004, it was clarified that Norwegian tax rules concerning taxation on dividend

Norway

was discriminatory and contrary to the EEA agreement (ref. European Free Trade Association (EFTA) and CJ's decisions in *Manninen*, *Fokus-Bank* and *Denkavit*). In the years 1994 to 2004, dividend distribution from a Norwegian resident company to a Norwegian resident shareholder was in practice tax-free while dividends received from, or distributed to a company within the EU/EEA were subject to Norwegian tax.

In 2006, the Norwegian Tax Authorities acknowledged that tax which had been levied contrary to EEA law should be repaid to the taxpayers. The ability to get a refund was however limited to tax levied three years back in time i.e., from 2003 and forward. The Supreme Court case concerns whether the taxpayers are also entitled to a refund or compensation for tax imposed on dividend payments during the period 1994 to 2002.

The taxpayers' repayment claims were based on the principle *Condictio Indebiti* in Norwegian domestic law and according to EU/EEA law. The Supreme Court ruled that the 6 month statute of limitation in the Norwegian Tax Payment Act also applies to the taxpayers' repayments claims. The claims were filed before the court between 2005 and 2007 and thus regarded as being submitted too late.

The taxpayers furthermore claimed damages under Norwegian law for unlawfully incurred tax, and under the specific legal EU/EEA liability for wrongful implementation of the EEA agreement. The Supreme Court ruled that the strict liability principle according to Norwegian domestic law did not apply in the case at hand. The Supreme Court furthermore concluded that the Norwegian state could not be made responsible for the breach of its obligations under the specific EU/EEA legal liability principles. The Supreme Court conclusion seems to be based on the opinion that the "substantial breach" criteria were not met prior to 2004 when the CJ issued its ruling the *Manninen* case.

Spain

The EU Commission requires Spain to abolish tax scheme favoring acquisitions in non EU- countries

Executive summary

On 12 January 2011, the EU Commission requested that Spain under EU state aid rules, abolish a tax provision that allows Spanish companies to amortize the financial goodwill deriving from acquiring a stake in non-EU companies. The Commission also ordered Spain to recover any unlawful aid granted under this provision after 21 December 2007, with the exception of acquisitions of entities in countries where obstacles to cross-border legal combinations have been or can be demonstrated.

Detailed analysis

Article 12(5) of the Spanish Corporate Tax Act, which is in effect since 1 January 2002 allows Spanish companies to take the amortization of financial goodwill embedded in shares of non-Spanish companies as a tax expense. As a result, a Spanish company acquiring at least a 5% stake in a foreign subsidiary could deduct from its taxable base the difference between the acquisition cost of the shares and the market value of the underlying assets of the foreign company during the 20 years following the acquisition.

In 2007, the Commission began a formal investigation as to what extent this financial goodwill facility provided an advantage to Spanish companies acquiring foreign entities. On 28 October 2009, the Commission requested that Spain abolish this provision in respect of the acquisition of entities resident in an EU country.

The Commission reached its conclusion by comparing the conditions under which it was possible to deduct the goodwill that may arise on Spanish domestic mergers and the conditions under which it was possible to achieve amortization on the financial goodwill embedded in the shares of a non-Spanish EU- resident company. The Commission specifically took into account that after the legislative harmonization achieved within the EU, the merger of Spanish and other European companies was possible and this made the advantage unjustifiable with regard to European acquisitions.

However, Spain alleged that the existence of obstacles to cross-border mergers justified the maintenance of the financial goodwill amortization facility for entities resident in non-EU States and the Commission kept the investigation open in connection with these acquisitions to examine the obstacles alleged by Spain to cross-border mergers.

In the decision issued on 12 January 2011, the Commission concluded that it could not identify any such explicit obstacles in the vast majority of the non-EU countries whose legislation was examined and, consequently, article 12 (5) also amounts to a clear and unjustified tax advantage in the case of acquisitions in non-EU countries.

The Commission, therefore, asked Spain to repeal the provisions relating to amortization of goodwill for acquisitions outside the EU and recover the unlawful aid granted after 21 December 2007, with the exceptions of entities in countries where obstacles on cross-border legal combinations have been or can be demonstrated such as India and China. The Commission understands that, due to the existence of legitimate expectations of the beneficiaries of the tax measure, the recovery should not apply with regard to acquisitions made before 21 December 2007, which is the date on which the decision to initiate the in-depth investigation in respect of article 12(5) was published.

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