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## 1. State Aid / WTO

### ECJ declares Commission's decision on Gibraltar invalid (*Gibraltar v Commission*)

On 18 December 2008, the Court of First Instance ('CFI') annulled a Commission decision on a proposed Gibraltar Tax Reform in the *Gibraltar v Commission* case (T-211/04 and T-215/04). According to the Commission's 2004 decision, the proposed Gibraltar system was both regionally and materially selective. The CFI has now ruled that Gibraltar met the conditions for regional sovereignty as set forth in the *Portugal* and *Azores* decisions of 2005 and 2008. It had sufficient political, procedural and economic/financial autonomy. As for the latter, the CFI pointed out that any financial support from the UK to Gibraltar did not necessarily indicate lack of autonomy to determine tax policy, as long as such support is not causally linked to the tax reform. As a result, the Commission should have taken the Gibraltar system itself as a starting point and not the UK tax system.

As for material selectivity, the Commission focussed mainly on the proposed payroll tax and business property occupation tax (BPOT), which will both be capped at 15% of the company's profit. At the same time, Gibraltar abandoned its corporation tax, apart from a top-up tax of 4% to 6% of profits from financial services. The latter tax may aggregate with the two first-mentioned taxes up to the same 15%.

The CFI, however, pointed out that the Commission had failed to determine the proper benchmark, i.e. the normal Gibraltar tax regime that serves as point of reference to determine the presence of selective benefits. The Commission pointed out that the proposed Gibraltar system was meant to effectively provide favourable tax treatment to off-shore financial companies, i.e. the same category of companies

previously subject to the 'exempt companies' regime, which Gibraltar had to abandon.

The CFI pointed out that it was for Gibraltar to spread the tax burden of its normal tax regime as it seems fit over the different factors of production and economic sectors. The CFI was very critical of the Commission's remarks that the Gibraltar taxes were not 'pure' payroll and property taxes, taking the profit cap into account. The CFI pointed out that the new Gibraltar tax system may form a common or normal tax system in its own right, without reference to 'pure' tax systems. The CFI took into consideration the Gibraltar Government's argument that the tax reform intended not to tax unprofitable companies.

It is now up to the Commission to either appeal the decision at the ECJ or to take a new decision. In such decision, the Commission must first determine the normal Gibraltar tax system as a benchmark, taking into account that even the 'normal' regime may be more beneficial to some companies than others without necessarily meeting the criterion of 'selectivity' necessary to fall within the scope of Article 87 EC.

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### **CFI upholds series of decisions declaring Basque tax incentives illegal aid (*Diputación Foral de Álava and Gobierno Vasco v Commission*)**

In a series of three judgements dated 9 September 2009, the CFI ruled on 18 appeals in total, in the *Diputación Foral de Álava and Gobierno Vasco v Commission* joined cases (T-30/01 to T32/01, T-86/02 to T-88/02, T-227/01 to T-229/-01, T-265/01, T-266/01, T-270/01, T-230/01 to T-232/01, and T-267/01 to T-269/01). These judgements related to three different tax incentives granted autonomously by three Basque Territories: (i) a 1995 45% investment tax credit in respect of investments of over ESP 2.5 Billion, (ii) a 1993-1994 incentive granting a 10-year corporate tax exemption to companies with, amongst others, a minimum capital of ESP 20 Million who invest at least ESP 80 Million and create at least 10 jobs within six months after establishment that is to be maintained, and (iii) a 1996-1997 incentive granting a degressive tax base reduction of 99% down to 25% in four years to companies meeting the latter criteria as well.

Numerous procedural and material claims had been made by the local authorities involved and by a local business association. These included claims that these benefits were to be considered existing aid because of previous positions allegedly taken by the Commission. While in some cases, 79 months had passed between the receipt of a complaint which led to the start of a preliminary investigation and the official opening of a formal investigation, the CFI pointed out that this rather long period could not have given rise to legitimate expectations given the role of the local authorities, who did not fully cooperate with information requests.

The Commission also argued that it needed time to gather and analyse the necessary data given the complexity of the case at hand and that it could only act after having received a second complaint in 2000. Neither the 1998 Commission notice on state aid to business taxation nor the 1997 Code of Conduct on Harmful tax competition affected the criteria for State aid assessment, thus the CFI. Other arguments put forward stated that the Commission misused its State aid control powers to advance fiscal harmonisation, which was rejected as unfounded. Also, quotes in the press and in the Spanish Senate of comments allegedly made by the Commissioner for Competition could not have raised expectations in the absence of a clear and explicit position actually having been taken by the Commission in previous years. The CFI also reminded parties that recovery of aid even after several years was not to be considered a penalty under EU law, but proportionate to the objective of restoring the status quo prior to the receipt of illegal aid.

Having rejected all pleas, the CFI decided that the nine contested decisions from the year 2001 had to be upheld and that, given the presence of final decisions, the parallel appeals against the Commission opening the formal investigations in 1999 had become without relevance.

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### **CFI upholds Azores decision (*Banco Comercial dos Açores v Commission*)**

On 10 September 2009, the CFI upheld the Commission Decision C(2002) 4487 final not to allow the financial sector to be eligible for a reduction of the income tax rate applicable in the Azores area in the *Banco Comercial dos Açores v Commission* case (T-75/03). The CFI pointed out that the Azores as such had no regional autonomy to the degree necessary to avoid State aid rules, as set forth in the 2006 ECJ decision in the *Portugal v Commission* case (C-88/03). Since the authorities failed to provide data to prove that the financial sector would need to be included in the tax benefit, meant to compensate for the Azores being an outermost area of the EU, the Commission was allowed to exclude the sector and to recover aid already granted to this sector, thus the CFI.

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### **ECJ rules Sardinian airport tax to be both an infringement of freedom of services and State aid (*Presidente del Consiglio dei Ministri v Regione Sardegna*)**

On 17 November 2009, the ECJ rendered its judgment in the *Presidente del Consiglio dei Ministri v Regione Sardegna* case (C-169/08), concerning the compatibility of the Sardinian airport tax with EC law. In 2006, Sardinian regional authorities introduced a tax on stopovers of aircraft and boats from June through September, i.e. during the tourist season. Vessels excluded from this tax are, amongst others, boats normally lying in local harbours. First, the ECJ ruled that, given the environmental objective of the stopover tax, it is unwarranted to make a difference between local operators (who pay general taxes) and operators from outside Sardinia that would be paying the stopover tax. The service recipients – the natural or legal persons using the stopover service (i.e. tourists) – are considered to be in an objectively comparable situation. As a result, the difference in taxation is deemed disproportional in light of the environmental justification of the tax. Given the differences between general taxes in Sardinia and the specific tax on stopovers, the cohesion of the tax system can also not be accepted as a justification of the infringement of the freedom to provide services vis-à-vis the undertakings whose tax domicile is outside of Sardinia.

Moreover, the ECJ ruled that the exclusion of local undertakings from the stopover tax would also amount to State aid. Since the undertakings performing the stopover service are in a comparable situation whether their tax domicile is inside or outside Sardinia, the tax exemption would confer a benefit in favour of local undertakings.

#### *Preliminary comments*

It should be noted that the ECJ's latter finding is disputable given that the facts of the case do not clarify whether the majority of stopovers were provided by non-resident undertakings. It does seem that the ECJ assumed, without referring the matter back to the national court, that the majority of undertakings would be paying the stopover tax – the benchmark – while local companies would profit from being exempted from such tax, in which case, this would indeed have resulted in a financial advantage. If the ECJ meant to establish that, given that all companies are in a comparable situation, any exemption of the tax would lead to aid (even if all but few companies would actually be exempted), the State aid definition of Article 107(1) of the Treaty on the Functioning of the European Union ('TFEU') which came into effect on 1 December 2009 (i.e. identical to the former Article 87(1) EC), would have been changed substantially overnight. Future ECJ rulings, therefore, will have to be awaited in order to clarify this issue.

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### **Conditional and partial approval of German tax scheme for risk capital**

On 1 October 2009, the Commission authorized a German proposal providing income tax benefits for private individuals who provide risk capital to companies, subject to some minor amendments. The benefit will be available upon realization of capital gains upon the sale of any participation in future should normal return of investment be insufficient and the maximum benefit will be limited to around EUR 22,500 per investor. On the other hand, however, the Commission could not accept provisions providing business tax benefits to venture capital companies ('VCCs') and provisions allowing for the carry forward of losses – despite a full acquisition – by certain target companies acquired by such VCCs. One of its main concerns was that the VCCs would be required to have their domicile and management in Germany. The latter would be in direct violation of both the freedom of establishment (Articles 43 and 48 EC) and

the Commission's risk capital guidelines.

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## **Commission approves of Dutch Group Interest Box**

On 8 July 2009, the Commission closed its formal investigation into the Dutch Group Interest Box which was notified in 2006. According to the press release, the Commission has decided to come back on its opinion as reflected in the decision to open a formal investigation of 2007, and has ruled that the Group Interest Box regime does not qualify as State aid taking account of commitments made by the Dutch authorities. The formal investigation took almost 30 months, instead of the normal target of 18 months set to close such an investigation.

The Commission concluded that the new box will not favour any particular companies or sectors of industry and therefore lacks the selectivity required to qualify as State aid. In order to reach this conclusion three commitments were of importance. First, the new box will no longer be optional but obligatory. In its 2007 decision, the Commission argued that the optional character would mainly lead to internationally operating companies opting for the regime, whereas this would no longer be an issue with the obligatory character. The press release, however, did not clarify why the Commission's point of view that the box mostly benefitted international companies has changed as a result of making the box obligatory. Second, the commitment was undertaken to drop the statutory capital requirement for setting up private companies with limited liability ('BVs') in the Netherlands. As a result, even small companies would have easy access to the Group Interest Box because it would be able to become part of a group although as yet, it is unclear from the press release why this was considered relevant for the Commission's change in thought. Third, the Dutch Government committed itself to enlarging the scope of the group company definition to situations where certain entities effectively controlled the financing of others.

On 5 December 2009, the State Secretary of Finance sent a letter to Parliament in which he announced his intention to abandon the plans to introduce the long anticipated mandatory group interest box and certain measures to restrict the deductibility of interest in the near future. The feasibility of these measures will be taken into account in a broader study of the Dutch tax system, which is currently set up by a specific Study Committee.

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## **Hungarian intra-group tax regime declared existing aid**

On 30 October 2009, after more than 2½ years, the State aid investigation into a Hungarian 2003 intra-group interest incentive was closed. The incentive would allow for a tax deduction of 50% of net interest received from affiliated companies, while the affiliated company would have to add that same amount to the tax base. This, therefore, would result in a shift in tax base between the interest recipient and the interest payer. The Commission found the incentive to be State aid, but given its introduction prior to Hungary's accession to the EU in 2004 and uncertainties regarding its State aid character, the Commission deemed the regime to be existing aid. As a result, there will be no recovery of aid already granted. The Commission will also not initiate proceedings to bring the regime to an end since Hungary is to repeal the scheme as from 1 January 2010.

### *Preliminary comments*

It should be noted that the Commission referred to the 'pre-accession' context of the Hungarian regime and the Commission's own decision-making practice in respect of the Belgian Coordination Centre ('BCC') regime back in 1984 and 1987 to establish special circumstances warranting non-recovery by deeming the regime to be existing aid. Although the Commission's final ruling in respect of the BCC regime dated from February 2003, its opening of a formal investigation in 2001 would normally have been considered a signal to other parties that relying on any previous assessment could not be done without restraint. While this again seems to establish a dangerous precedence for the adherence to State aid recovery procedures – given that Hungary had a chance to bring up the regime during accession negotiations and thereafter – there would seem to be a second contradiction. According to the final decision, the exclusion of small and medium-sized enterprises from the regime in itself constituted unwarranted 'selectivity' of the regime, which should have been clear to all those involved even prior to the introduction of the Hungarian regime in 2003. This would

have allowed for an alternative ruling of new aid which, given that it had been granted unlawfully, could have been the subject of a recovery order all the same.

Some attention should also be given to the Commission's finding that the optional character of the Hungarian regime contributed to its selectivity because of a differentiated treatment between group companies, since such regime would not apply to all group companies but only to those that decided to opt-in for the fiscal year concerned. Regrettably, the Commission did not provide grounds to substantiate this claim, while it has not been disputed that those companies that did not opt-in could have chosen to do so anyway. Hopefully, future decisions will clarify this matter.

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## **Spanish goodwill scheme declared illegal aid and is to be recovered in part**

On 28 October 2009, the Commission ruled that a Spanish allowance to write off goodwill that arose when acquiring non-Spanish companies constitutes State aid. It would allow Spanish companies an advantage in competitive takeover bids. In respect of takeovers within Spain, amortisation would only be allowed upon full consolidation of businesses into one entity, which would not be required in an EU context. Any write off allowed on European acquisitions since 21 December 2007 will be subject to a recovery order while the Commission continues its investigation into non-EU takeovers. According to the press release, recovery will not cover the period between 2002 and 21 December 2007 (the date at which the formal investigation into the scheme was opened), due to the existence of (unspecified) legitimate expectations.

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## **2. Direct Taxation**

### **Commission adopts Communication on proposal for a revised Code of Conduct for the effective implementation of the EU Arbitration Convention on transfer pricing disputes**

On 14 September 2009, the Commission adopted Communication COM(2009) 472 final on the work of the EU Joint Transfer Pricing Forum ('JTPF') in the period March 2007 to March 2009, including a proposal for a revised Code of Conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC) of 23 July 1990 (the 'EU Arbitration Convention'). On the same date, the Commission also published an accompanying staff working document containing a summary report on penalties in transfer pricing.

#### *Background*

Whilst most bilateral double taxation treaties include a provision for a corresponding downward adjustment of profits of the associated enterprise concerned, they do not impose a binding obligation on the contracting States to eliminate the double taxation. The EU Arbitration Convention aims at improving the conditions for cross-border activities in the Internal Market. It establishes a procedure to resolve disputes where double taxation occurs between enterprises of different Member States as a result of an upward adjustment of profits of an enterprise of one Member State including, if necessary, reference to the opinion of an independent advisory body.

On 23 April 2004, the Commission adopted Communication COM(2004) 297 final on the work of the JTPF in the field of business taxation from October 2002 to December 2003, and on a proposal for a Code of Conduct for the effective implementation of the EU Arbitration Convention. The proposed Code of Conduct was adopted by the Council on 7 December 2004. The Code of Conduct applies in cases where a Member State's tax administration increases the taxable profits of a company from its cross-border intra-group transactions, for example, by making a transfer pricing adjustment. It ensures a more effective and uniform application by all Member States of the EU Arbitration Convention by establishing common procedures concerning:

- the starting point of the three-year period which is the deadline for a company suffering double taxation to present its case to the relevant Member State's tax

administration;

- the starting point of the two-year period during which Member States' tax administrations must attempt to reach an agreement that eliminates the double taxation that is the subject of the complaint;
- the arrangements to be followed during this mutual agreement procedure, i.e. the practical operation of the procedure, transparency and taxpayer participation; and
- the practical arrangements for the second phase of the dispute resolution procedure provided for in the EU Arbitration Convention that must follow if there is no mutual agreement between the tax authorities within two years, i.e. the establishment and functioning of the advisory commission that must then arbitrate in the case.

The Code of Conduct also contains a recommendation to Member States to suspend the tax collection during cross-border dispute resolution procedures. It is also recommended that Member States extend those rules to double tax treaties concluded between Member States.

#### *New proposal*

The September 2009 proposal for a revised Code of Conduct is the result of a monitoring exercise performed by the JTPF, aiming to improve the smooth functioning of the EU Arbitration Convention by providing common interpretation on the following topics.

#### 1. Admissibility of a case

Member States are recommended to consider that a case is covered by the EU Arbitration Convention when the request is presented in due time after the date of entry into force of accession by new Member States to the EU Arbitration Convention, even if the adjustment applies to earlier fiscal years.

#### 2. Scope of the EU Arbitration Convention

The EU Arbitration Convention covers:

- all EU transactions involved in triangular transfer pricing cases among Member States, i.e. a case where, in the first stage of the EU Arbitration Convention procedure, two EU competent authorities cannot fully resolve any double taxation arising in a transfer pricing case when applying the arm's length principle because an associated enterprise is situated in (an)other Member State(s); and
- any thin capitalization cases, i.e. profit adjustments arising from financial relations, including a loan and its terms, and based on the arm's length principle.

#### 3. Serious penalties

Serious penalties covered by Article 8(1) EU Arbitration Convention, whereby access to the EU Arbitration Convention may be denied, should only be applied in exceptional cases like fraud. In the staff working document containing a summary report on penalties in transfer pricing, the JTPF concluded that it is necessary to harmonize the different definitions of a serious penalty adopted by the 27 Member States.

#### 4. Cross-border dispute resolution procedures, domestic litigation and interest charged

When a case is dealt with under the EU Arbitration Convention, Member States are recommended to take all necessary measures to ensure that the suspension of tax collection during cross-border dispute resolution procedures under the EU Arbitration Convention can be obtained by enterprises engaged in such procedures, under the same conditions as those engaged in a domestic appeal/litigation proceedings although these measures may imply legislative changes in some Member States. Furthermore, Member States are recommended to apply one of the following approaches:

- tax to be released for collection and repaid without attracting any interest, or
- tax to be released for collection and repaid with interest, or
- each case to be dealt with on its merits in terms of charging or repaying interest (possibly during the mutual agreement procedure process).

#### 5. Advisory commission and independence of arbitrators

Several points pertaining to the functioning of the EU Arbitration Convention were clarified as regards rules on the deadline for the setting-up of the advisory commission and the criteria for establishing the independence of arbitrators.

The Commission noted that the following issues need further discussion: the

possibility of setting up a permanent and independent secretariat and the interaction between the EU Arbitration Convention and Article 25.5 of the OECD Model Tax Convention. The proposal for a revised Code of Conduct has to be adopted by the EU Council of ministers.

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## **Treaty of Lisbon fully ratified by all 27 Member States**

The Treaty of Lisbon, officially signed by the Heads of the Member States on 13 December 2007, has finally been fully ratified. Under EC law, the Treaty had to be ratified by all 27 Member States before coming into force. The last country to ratify the Treaty was the Czech Republic, which completed the process on 3 November 2009, after receiving the same exemption as Poland and the United Kingdom from 'protocol 30' in the Lisbon Treaty's Charter of Fundamental Rights. Germany ratified the Treaty on 25 September, but only after extra parliamentary safeguards demanded by the constitutional court were approved. Poland ratified the Treaty on 10 October, a week after the Irish voted 'yes' in a second referendum held 16 months after the Treaty was rejected in a first referendum. The Treaty is expected to enter into force officially on 1 December 2009.

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## **ECJ finds German legislation concerning continuation of book values in case of exchanges of participations incompatible with the Merger Directive (A.7.)**

On 11 December 2008, the ECJ rendered its judgment in the *A.7.* case (C-285/07) concerning the compatibility of German rules on the continuation of book values in the case of exchanges of participations with Community law, more specifically, the freedom of establishment, the free movement of capital and Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States (the 'Merger Directive').

In the year of controversy (2000), a German AG ('A.T.') held an 89.5% participation in a German GmbH ('GmbH'). On 28 April 2000, A.T. contributed its participation in GmbH to the capital of a French société anonyme ('S.A.'), in exchange for 2,136,372 new shares in the latter, corresponding to 1.47% of its stock capital. S.A. valued the GmbH shares (the shares in the acquired company) in its trading and tax balance sheets (drawn up in accordance with French law) at the market value ascribed to them in the transfer contract instead of at their lower book value, although it appears that French law would have permitted the book value to be used. A.T. sought to value the shares which it had been allotted in the French company at the book value of the GmbH shares for which the French company's shares had been exchanged.

Pursuant to provisions of the *Umwandlungssteuergesetz* ('UmwStG'), the German tax administration started proceedings against A.T., challenging the continuation of book values of the participation in GmbH, after these shares had been exchanged for the new shares in S.A., and claiming that the difference between the original initial costs of the participation in GmbH and the market value of the participations in S.A. was taxable in Germany. A.T. successfully challenged the tax assessment notices before the German Tax Court of Baden-Wurtemberg. The German tax administration appealed to the German Federal Tax Court, which in turn, referred the matter to the ECJ, asking whether the first sentence of Paragraph 23(4) read in conjunction with the first sentence of Paragraph 20(4) UmwStG and the 'double book value carryover' condition applicable under those provisions were contrary to Article 8 (1) and (2) of the Merger Directive and to Articles 43 and 56 EC.

The ECJ generally followed the Opinion of Advocate General Sharpston issued on 6 November 2008, and concluded that the aforementioned German legislation, which required the double book value carryover of the historical book value of the shares transferred, was incompatible with the Merger Directive. Focusing on the wording of Article 8 (1) and (2) of the Merger Directive and based on ECJ's decision in the *Kofoed* case (C 321/05) and the *Leur Bloem* case (C-28/95), the ECJ upheld that Member States have no discretion to impose additional conditions that must be satisfied before the fiscally neutral treatment prescribed in the Merger Directive is accorded. Only by way of exception and in specific circumstances determined on a case-by-case basis may Member States, pursuant to Article 11(1)(a) of Merger

Directive, refuse to apply or withdraw the benefit of all or any part of the provisions of the Merger Directive where the transaction has as its principal objective or as one of its principal objectives tax evasion or tax avoidance.

The ECJ observed that in the present case, there was no suggestion that the share transaction was carried out for the purposes of tax evasion or tax avoidance. Rather, A.T. was required to divest itself of the shares by virtue of (mandatory) stock exchange rules. The fact that the stock exchange price of S.A. shares had fallen significantly, did not justify treating the exchange of shares alone as a chargeable event for tax purposes, since at the time of the exchange, the hidden reserves remained as yet unrealised. Moreover, as noted by the Court, it would not be the German tax authorities which would benefit, with a view to the taxation of a subsequent disposal of the shares transferred, from the carryover of the historical book value of those shares to the books of the acquiring company, but, at best, the French tax authorities. It is, moreover, all the more difficult to detect a real interest in the requirement of double book value carryover of the historical book value of the shares transferred because the UmwStG had in the meantime been amended so that since the beginning of 2007, that requirement had no longer been applied to exchanges of shares involving companies from different Member States.

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### **ECJ considers Hungarian company law restricting the transfer of operational headquarter to another Member State compatible with EC law (*Cartesio*)**

On 16 December 2008, the ECJ rendered its judgment in the *Cartesio* case (C-210/06) concerning the restriction imposed by Hungarian company law on the transfer of operational headquarters to another Member State. Differing from Advocate General Maduro's Opinion of 22 May 2008, the ECJ upheld that Articles 43 EC and 48 EC are to be interpreted as not precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation.

*Cartesio* is a limited partnership constituted in accordance with Hungarian law and registered in Hungary. In November 2005, *Cartesio* asked the commercial court to record in the commercial register the transfer of its operational headquarters from Hungary to Italy, but wished to remain subject to Hungarian company law. The commercial court refused to conform to this request on the basis that such transfer was not allowed under Hungarian law. It stated that, in order to change its operational headquarters, *Cartesio* would first have to be dissolved in Hungary and then reconstituted under Italian law. *Cartesio* lodged appeal against the decision of the commercial court before the Court of Appeal of Szeged, which in turn, asked the ECJ whether the Hungarian legislation at issue was compatible with the freedom of establishment, in addition to several questions concerning Article 234 EC.

At the outset, the ECJ observed that, as Community law now stands and in the absence of a uniform Community law definition of the companies which may enjoy the right of establishment on the basis of a single connecting factor determining the national law applicable to a company, the question whether Article 43 EC applies to a company which seeks to rely on the fundamental freedom enshrined in that article is a preliminary matter which can only be resolved by the applicable national law. The ECJ noted that, following the judgments in *Daily Mail* (C-81/87) and *Überseering* (C-208/00), the developments in the field of company law envisaged in Articles 44(2)(g) EC and 293 EC, respectively, as pursued by means of legislation and agreements, have not as yet addressed the differences, referred to in those judgments, between the legislation of the various Member States and, accordingly, have not yet eradicated those differences.

The ECJ concluded that a Member State has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment, and that required if the company is to be able subsequently to maintain that status. That power includes the possibility for that Member State not to permit a company governed by its law to retain that status if the company intends to reorganise itself in another Member State by moving its seat to the territory of the latter, thereby breaking the connecting factor required under the national law of the Member State of incorporation.

The ECJ does state, however, that the Member State of incorporation may not prevent a company from converting itself into a company under the laws of another Member State. This implies that the Member State of incorporation may not require that the company is wound up or liquidated, prior to shedding its law of incorporation and adopting the laws of that other Member State.

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### **ECJ rules on treatment of dividends from shares held in usufruct (*Les Vergers du Vieux Tauves*)**

On 22 December 2008, the ECJ gave its decision in the *Les Vergers du Vieux Tauves* case (C-48/07). In the subject case, the Belgian Court of Appeal of Liege asked the ECJ, in essence, whether a company which owns a right of usufruct over shares in another company may or must be regarded as a parent company within the meaning of Article 3 of the Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (the 'Parent-Subsidiary Directive').

*Les Vergers du Vieux Tauves* is a Belgian company that acquired shares in usufruct in another Belgian company. *Les Vergers du Vieux Tauves* wanted to deduct the dividends received from the shares held in usufruct from its taxable base pursuant to the Belgian implementation of the Parent-Subsidiary Directive. The Belgian tax authorities objected, stating that the holding of shares in usufruct was not a 'holding in the capital' within the meaning of the Parent-Subsidiary Directive.

Belgium has opted for the exemption method under the first indent of Article 4(1) of the Parent-Subsidiary Directive. In summary, under the relevant legislation dividends received from subsidiaries within the meaning of the Directive are, first, included in the basis of assessment of the parent company and, second, deducted as to 95% from that basis of assessment in so far as the parent company has taxable profits. The Belgian law of 28 December 1992, transposing the Parent-Subsidiary Directive to the 1992 Income Tax Code does not explicitly require the full ownership of the capital in the company distributing dividends and, therefore, implicitly permits the interpretation given by the taxpayer that the mere holding of a right of usufruct of shareholdings in the capital of the distributing company entitles the taxpayer to the participation exemption on such dividends. The Belgian Government explained that the implementing law was intended to extend also to an area not covered by the Parent-Subsidiary Directive, namely relations between domestic companies, in order to avoid reverse discrimination against Belgian companies with Belgian subsidiaries, as compared to Belgian companies with subsidiaries in other Member States, with regard to the treatment of dividends.

All the governments submitting observations raised the question of admissibility, although their views are divided. The applicant and the Commission both submitted that the reference was admissible. The observations as to admissibility essentially focus on two issues, the paucity of information in the order for reference and the apparent absence of any Community element. The ECJ considered that the reference in the present case, notwithstanding its lack of detail with regard to the factual and national law contexts, allowed the scope of the question referred to be established. Moreover, on the basis of the Court's settled case law, bearing in mind that there is a single national provision which transposes the Directive and simultaneously governs internal situations, it is clearly in the Community interest that that provision should be interpreted in the same way when applied to cross-border and domestic situations. Therefore, the ECJ decided in favour of admissibility of the case.

As to the substance of this case, the ECJ did not follow Advocate General Sharpston's Opinion of 3 July 2008 and ruled that the concept of 'holding in the capital of a company of another Member State', as mentioned in Article 3 of the Parent-Subsidiary Directive, does not include the holding of shares in usufruct. The ECJ based its ruling on the fact that the Parent-Subsidiary Directive seeks to eliminate cases of double taxation of profits distributed by subsidiaries to its parent companies and that the concept 'holding in the capital' refers to the legal relationship between the parent company, as shareholder, and the subsidiary. The Parent-Subsidiary Directive does not provide for the situation in which a parent company transfers a legal ownership with the subsidiary, such as usufruct, to a third party.

According to the ECJ, this interpretation is confirmed by the purpose of the provisions of the Parent-Subsidiary Directive. First, Article 4(1) of the Parent-Subsidiary

Directive covers the situation in which a parent company 'by virtue of its association with its subsidiary' receives dividends. A usufructuary, however, only receives dividends by virtue of its right of usufruct. Second, Article 4(2) of the Parent-Subsidiary Directive retains the option for the Member States to provide that losses resulting from the distribution of profits of the subsidiary may not be deducted from the taxable base of the parent company. In such way, Member States can prevent a parent company from enjoying a double tax advantage. A usufructuary, however, could never enjoy a double tax advantage since he only has a right to distributed profits. The profits placed in reserve revert to the legal owner. The usufructuary will thus never incur a loss.

Nevertheless, it is clear from the Court's case law that, whatever the mechanism adopted for preventing or mitigating the imposition of a series of charges to tax or economic double taxation, the freedoms of movement guaranteed by the EC Treaty preclude a Member State from treating foreign-sourced dividends less favourably than nationally sourced dividends, unless such a difference in treatment concerns situations which are not objectively comparable or is justified by overriding reasons in the general interest. Even though the main proceedings concerned a purely internal situation, the ECJ ruled that if a Member State exempts from taxation dividends received from shares held in usufruct in resident companies, dividends received from shares held in usufruct in a non-resident company cannot be treated less favourably and must also be exempt from taxation.

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### **ECJ concludes Belgian withholding tax on interest payments compatible with EC law (*Truck Center*)**

On 22 December 2008, the ECJ gave its decision in the *Truck Center* case (C-282/07), concerning Belgian withholding tax on interest payments to companies resident in other Member States.

*Truck Center*, a Belgian company, received a loan from a Luxembourg company that held a participation of 48% in *Truck Center*. Although Belgium was competent on the basis of the Belgian-Luxembourg tax treaty to levy withholding tax, no Belgian withholding tax was deducted from the interest accrued on the loan from 1994 to 1996. Therefore, the Belgian tax authorities assessed withholding tax for this period. *Truck Center*, however, was of the opinion that the Belgian legislation regarding withholding tax on interest payments to non-resident companies violated EC law, as interest payments to resident companies were exempt from withholding tax. The Court of Appeal, Liège decided to refer the question to the ECJ for a preliminary ruling on whether Belgian tax rule, read in conjunction with Article 23 of the Belgian-Luxembourg tax treaty (i.e. on the methods of avoidance of double taxation), infringes the Articles 43 and 56 EC.

Belgian tax law provides that interest paid on receivables or loans that are not represented by securities or that are represented by securities under the form of a negotiable instrument is exempt from Belgian withholding tax if the interest is paid to professional investors. 'Professional investors' are defined as (i) individuals residing in Belgium who are subject to Belgian income tax and that have used the interest bearing capital for their professional activities, (ii) resident companies that are not banks or financial institutions, and (iii) Belgian permanent establishments of foreign companies.

The ECJ observed that, in accordance with settled case law, this case should come within the scope of the freedom of establishment, since it involves national provisions which apply to holdings by nationals of the Member State concerned in the capital of a company established in another Member State, giving them definite influence on the company's decisions and allowing them to determine its activities. The ECJ ruled that no violation of EC law existed, as resident companies and non-resident companies were not in an objectively comparable situation with regard to the recovery of tax. Whereas resident companies are directly under the supervision of the Belgian tax authorities, which can ensure the recovery of taxes, this is not the case for non-resident companies, for which the recovery of taxes requires the cooperation of the tax authorities of the other Member State.

Moreover, the ECJ ruled that the difference in treatment does not necessarily procure an advantage for resident companies receiving interest payments. After all, interest received by resident companies is subject to Belgian corporate income tax and

resident companies are obliged to make advance payments for this corporate income tax. The amount of withholding tax deducted from the interest payments to non-resident companies is significantly lower than the corporate income tax on interest payments to resident companies.

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### **ECJ holds German rules regarding depreciation on shares in a foreign company incompatible with EC law (*STEKO Industriemontage*)**

On 22 January 2009, the ECJ rendered its decision in the *STEKO Industriemontage* case (C-377/07), concerning the compatibility of the German rules regarding depreciation on shares in a foreign company with the free movement of capital. The question in this case is whether it is allowed under the free movement of capital that domestic legislation denies depreciation on foreign shares in an earlier year than it does on domestic shares, i.e. during the transitional period.

STEKO is a limited liability company established in Germany, which held shares in non-resident companies amounting to less than 10%, as part of its investments in 2001. It is unclear whether the shares were held in companies resident in or outside the EU. In 2001, the German company depreciated on the value of the shares, as the fair market value of the shares decreased. The tax authorities refused the depreciation based on new legislation, disallowing such depreciation. However, this new legislation was not applicable to the depreciation of domestic shares in the year 2001, which was basically a transitional year. On 4 April 2007, the German Federal Tax Court decided to refer the case to the ECJ for a preliminary ruling.

The ECJ noted that the German legislation at issue gave rise to a genuine restriction of the free movement of capital in so far as the possibility of a resident company deducting from its taxable revenue reductions in profit resulting from a partial write-down of its holdings depended on whether they were held in a resident or non-resident company. The Court observed that the difference in treatment was not based on an objective difference in situations and that it was insignificant, in that regard, that the difference in treatment existed only for a limited period of time. The ECJ rejected the justifications put forward by the German government, based on the coherence of the tax system and the need to ensure effective fiscal control in respect of holdings in foreign companies established in non-EU countries.

Thus, the ECJ concluded that Article 56 EC must be interpreted as precluding a rule of domestic legislation which prohibits a resident company from deducting from its taxable revenue reductions in profit resulting from the partial write-down of holdings in non-resident companies, whereas, in the same year and, moreover, in identical circumstances, a resident company could deduct such reductions in profit from its taxable revenue where they related to holdings in resident companies.

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### **ECJ holds German legislation on deductibility of gifts in kind incompatible with EC law (*Persche*)**

On 27 January 2009, the ECJ rendered its decision in the *Persche* case (C-318/07), concerning the compatibility of the German legislation regarding deductibility of gifts in kind to Portuguese charities with EC law.

Based on German legislation, gifts in kind to foreign charities were not tax deductible, whereas, such gifts were tax deductible when donated to domestic charities. On 9 May 2008, the German Federal Tax Court decided to refer preliminary questions to the ECJ. The preliminary questions entailed (i) whether gifts in kind to a foreign charity fall within the free movement of capital of Article 56 EC, (ii) whether, if the free movement of capital is applicable, it is in line with Article 56 EC that gifts in kind are only tax deductible when donated to domestic charities, and (iii) whether the German tax authorities are obliged under Council Directive 77/799/EEC of 19 December 1977, concerning mutual assistance by the competent authorities of the Member States in the area of direct taxation (the 'Mutual Assistance Directive') to ask for assistance of the tax authorities in the other Member State in order to verify the facts presented in a case.

The ECJ concluded that the free movement of capital covered gifts in kind, in the

form of everyday consumer goods, by a taxpayer of a Member State to bodies established and recognised as charitable in another Member State. Based on established case law, the ECJ noted that the Mutual Assistance Directive did not contain an obligation for tax authorities of a Member State to request the necessary information from the tax authorities of other Member States. The Court also ruled that Article 56 EC must be interpreted as precluding legislation of a Member State by virtue of which, as regards gifts made to bodies recognised as having charitable status, the benefit of a deduction for tax purposes is allowed only in respect of gifts made to bodies established in that Member State, without any possibility for the taxpayer to show that a gift made to a body established in another Member State satisfies the requirements imposed by that legislation for the grant of such a benefit.

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### **ECJ holds Belgian dividend participation exemption regime incompatible with the Parent-Subsidiary Directive (*Cobelfret*)**

On 12 February 2009, the ECJ rendered its decision in the *Cobelfret* case (C-138/07) concerning the Belgian dividend participation exemption regime that was introduced when implementing the Parent-Subsidiary Directive. The question is whether or not Article 4(1) of the Parent-Subsidiary Directive precludes Belgian legislation which provides that dividends received by a parent company from its subsidiary are first included in the taxable basis of the parent company and can subsequently be deducted from this taxable basis in the amount of 95%, but only insofar as the parent company still has a positive profit balance after deduction of the other exempted profits (e.g. tax losses of the same tax period).

Cobelfret NV, a Belgian company, received dividends from its UK subsidiary in the course of the assessment years 1992 to 1998, but also suffered tax losses in the course of some of those years. The dividends received were added to its taxable base and the suffered tax losses were used to offset the profits resulting from the dividends received. Cobelfret could only apply the dividend participation exemption insofar as it had remaining profits after the compensation with the suffered tax losses. The unused part of the dividend participation exemption could not be carried forward and the carried forward tax losses of Cobelfret were reduced up to the amount of the dividends received. Following the reduction of the carried forward tax losses, the dividends received by Cobelfret would be indirectly taxed in the hands of Cobelfret in the following years.

The ECJ initiated by revisiting the fact that Article 4(1) of the Parent-Subsidiary Directive leaves the Member State of the parent the option to choose between the exemption method and the imputation method to avoid double economic taxation of dividends distributed by a subsidiary to its parent company. By introducing the dividend participation exemption regime, Belgium opted for the exemption method. However, the system of the dividend participation exemption regime only allows a parent company to benefit from the full exemption if it has not realised any losses in the same tax period. As the Member States cannot introduce unilaterally restrictive measures and thus impose conditions on the possibility to benefit from the advantages provided for in the Parent-Subsidiary Directive, the ECJ decided that the Belgian participation exemption regime was not compatible with the terms or the objective and scheme of this Directive.

All the arguments of the Belgian government were denied. According to the ECJ:

1. There is no significant difference between the concepts of 'refraining from taxation' and 'exempting the profits'. The fact that the Parent-Subsidiary Directive mentions 'to refrain from taxation' does not allow the restriction of the participation exemption regime to have such an effect on the losses of the parent company;
2. The fact that Belgium applies the same system to dividends received from Belgian companies as to dividends received from non-Belgian companies cannot justify a system that is incompatible with the Parent-Subsidiary Directive;
3. The choice between the exemption and the imputation system does not necessarily lead to the same result for the parent company receiving the dividends. Since Belgium opted for the exemption regime, it could not rely on the effects or restrictions which might have arisen from the implementation of the imputation system; and
4. Belgium cannot rely upon the provisions of the Merger Directive [Council Directive 90/434/EEG] or the OECD Model Convention to justify its system.

The Belgian government had requested the ECJ to limit the temporal effects of its judgment. The ECJ denied this request since the Belgian government had made no attempt to demonstrate the risk of serious economic repercussions if the decision was not limited in time.

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## **ECJ holds German legislation on foreign tax credit for inheritance tax purposes compatible with EC law (*Block*)**

On 12 February 2009, the ECJ rendered its judgement – without receiving Advocate General Mazák's Opinion – in the *Block* case (C-67/08), concerning the compatibility of the German legislation on foreign tax credit for inheritance tax purposes with Community law.

Ms Block, who is resident in Germany, is the sole heir of a person who died in 1999 in Germany, where the deceased was last resident. The estate essentially consisted of capital assets, of which DEM 144,255 were invested in Germany, and the remainder – an amount equivalent to DEM 994,494 – with financial institutions in Spain. Ms Block paid inheritance tax in Spain in the amount of DEM 207,565 in respect of the latter assets. In its notice of assessment, the German tax administration fixed the inheritance tax payable by Ms Block in Germany without taking into consideration the inheritance tax paid in Spain. Ms Block requested that the inheritance tax paid in Spain be credited against the inheritance tax to be paid in Germany, instead of being deducted from the basis of assessment in the same way as a debt of the estate. The German Tax Court, however, took the view that it was not possible to credit Spanish inheritance tax. According to the German Tax Court, whilst double taxation would occur with respect to the capital claims at issue, it is not for the German tax authorities to subsidise other Member States.

Under the disputed German legislation, the Spanish inheritance tax cannot be credited against the German inheritance tax due to the fact that, in Germany, inherited assets such as capital claims against financial institutions in Spain are excluded from the definition of 'foreign assets' which, under national rules, establish an entitlement to have inheritance tax paid abroad credited against inheritance tax payable in Germany. On 16 January 2008, the German Federal Tax Court referred the case for preliminary ruling by the ECJ, essentially asking whether Articles 56 and 58 EC must be interpreted as precluding the rules of a Member State (here: Germany) which do not provide for double taxation relief for foreign inheritance taxes paid to an heir resident in that Member State in respect of capital claims against a financial institution in another Member State (here: Spain), where the person whose estate is being administered was, at the date of death, residing in the first Member State (see EU Tax Alert, edition 55, May 2008).

The ECJ observed that the inheritance at issue in the main proceedings constitutes a movement of capital for the purposes of Article 56(1) EC. However, the Court concluded that the fiscal disadvantage resulting from the parallel exercise of the fiscal sovereignty by the two Member States concerned does not represent a restriction on exercising of the free movement of capital. Therefore, in a situation such as that in the main proceedings, the fact that Germany had decided to make capital claims subject to German inheritance tax where the creditor is resident in Germany, while Spain has decided to make such claims subject to Spanish inheritance tax where the debtor is established in Spain, does not constitute a breach of Article 56(1) EC.

Furthermore, the Court observed that in the current stage of the development of Community law, Member States enjoy a certain autonomy in this area provided they comply with Community law, and are not obliged, therefore, to adapt their own tax systems to the different systems of tax of the other Member States in order, *inter alia*, to eliminate the double taxation arising from the exercise in parallel by those Member States of their fiscal sovereignty. The ECJ concluded that, according to the settled case law, the EC Treaty offers no guarantee to a citizen of the Union who, in transferring his residence to a Member State other than that in which he previously resided, will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage or not, according to circumstances.

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## **ECJ rules on the extension of Cobelfret to dividends received from**

## **domestic subsidiaries and third country subsidiaries (*KBC Bank and Beleggen, Risicokapitaal, Beheer*)**

On 4 June 2009, the ECJ ruled in the joined cases *KBC Bank* (C-439/07) and *Beleggen, Risicokapitaal, Beheer* (C-499/07) concerning the Belgian dividend participation exemption. Belgian legislation provides that dividends received by a parent company from its subsidiary are first included in the taxable base of the parent company and subsequently deducted from this taxable base up to 95% ('Dividend Received Deduction' or 'DRD'). The DRD, however, is limited to the positive taxable base of the parent company after deduction of other exempted profits or tax deductible expenses. Unused DRD cannot be carried forward. Hence, the Belgian participation exemption regime only allows a parent company to benefit from a full exemption of the dividends received if, during the same tax period, it has not realised losses or borne tax-deductible expenses exceeding the taxable 5% of the dividend received.

The Brussels Court of Appeal and the Court of First Instance of Bruges referred four preliminary questions to the ECJ. The first question was whether Article 4(1) of the Parent-Subsidiary Directive precludes Belgian legislation limiting the benefit of the participation exemption for dividends received from subsidiaries resident in another Member State to the amount of taxable profit after deduction of other exempted profits or tax deductible expenses. In this regard, the ECJ referred to its decision in the *Cobelfret* case (C-138/07), where it decided that Article 4(1) of the Parent-Subsidiary Directive precludes the Belgian dividend participation exemption regime.

If the answer to the first question was that Article 4(1) of the Parent-Subsidiary Directive precludes the Belgian dividend participation exemption regime, the second question was whether Article 4(1) of the Parent-Subsidiary Directive then also precludes legislation that limits the benefit of the participation exemption regime in the same way when it concerns a domestic situation. The ECJ decided that, when domestic legislation extends the EC systems (such as the dividend participation exemption regime) to purely domestic situations, it is for the national court to decide on the exact scope of this extension. Hence, the question referred should be assessed by the national courts.

If the answer to the first two questions was that the Belgian dividend participation exemption regime is contrary to Article 4(1) of the Parent-Subsidiary Directive, the third question posed by the national court was whether Article 56 EC precludes Belgium from applying the participation exemption regime to dividends received from subsidiaries in non-EU countries. According to the ECJ, it is up to the national courts to examine whether Article 56 EC is applicable and, if it is applicable, whether it precludes legislation that treats dividends received from a non-EU subsidiary less favourably than dividends received from an EU subsidiary.

Finally, with the fourth question, the national court asked the ECJ whether Article 43 EC precludes national legislation that entirely exempts profits generated by a non-Belgian permanent establishment whereas it limits the participation exemption for dividends received from a non-Belgian subsidiary. The ECJ decided that Article 43 EC does not preclude such legislation as the referring courts do not demonstrate that a Belgian parent company is treated less favourably when receiving dividends from a non-Belgian subsidiary than when receiving dividends from a Belgian subsidiary. Nor it is proven that a Belgian parent company is treated less favourably when receiving dividends from a non-Belgian permanent establishment than when receiving dividends from a Belgian permanent establishment.

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## **ECJ holds Netherlands legislation on longer recovery period for foreign credit balances compatible with EC law (*X and E.H.A. Passenheim-van Schoot*)**

On 11 June 2009, the ECJ rendered its judgment in the joint cases *X and E.H.A. Passenheim-van Schoot* (C-155/08 and C-157/08), concerning additional assessments made by the Netherlands tax authorities following the discovery of assets held in another Member State and income from those assets that had been concealed.

In the first case at hand, the Belgian Special Taxation Inspectorate spontaneously forwarded to the Netherlands tax authority information on financial accounts held in

the name of Mr X, and of other Netherlands residents who were natural persons, at Kredietbank Luxembourg ('KB-Lux'), a bank established in Luxembourg. In 2002, Mr. X received an additional assessment to wealth tax payable in respect of 1998, including adjustments concerning first, income tax and social insurance contributions for the tax years from 1993 to 2000, and second, wealth tax for the tax years from 1994 to 2001. A fine amounting to 50% of the additional amounts sought was also imposed on X.

As to the facts of the second case, in 2003, on her own initiative, Mrs Passenheim-van Schoot had made a full disclosure to the Netherlands tax authority of balances held by herself and her late husband at a bank established in Germany. Until that time, those balances had never been included in their declarations relating to income tax, social insurance contributions and wealth tax. Mrs Passenheim-van Schoot was granted the benefit of the 'repentance' scheme and, therefore, no fine was imposed. However, in 2005, she received additional assessments for recovery concerning first, income tax and social insurance contributions for the tax years from 1993 to 1996 and second, wealth tax for the tax years from 1994 to 1997, together with related decisions with regard to interest.

Articles 16(3) and 16(4) of the State Taxes Act (*Algemene wet inzake rijksbelastingen*, the 'AWR') provides for a recovery period of 12 years with respect to foreign credit balances or income therefrom, in order to compensate for the lack of effective means of monitoring, whereas a recovery period of five years applies in the case of savings balances or income therefrom held in the Netherlands. In both cases, the Netherlands Supreme Court referred preliminary questions to the ECJ, asking, in substance, whether Articles 49 and 56 EC must be interpreted as precluding the disputed Netherlands legislation.

The ECJ observed that when a taxpayer fails to declare such domestic assets or income to the tax authorities, he is already certain after five years that they will no longer be taxed, whereas, when assets or income in another Member State are not declared, that certainty only comes into being after 12 years. In addition, where the extended recovery period laid down in Article 16(4) of the AWR is applied, the taxpayer runs the risk of a fine calculated on the basis of an additional assessment covering a longer period than that which may be taken into account in a situation in which the taxable items which are the subject of the additional assessment are held or has arisen in the Netherlands. It follows that legislation such as that at issue in the main proceedings constitutes a restriction both of the freedom to provide services and of the free movement of capital, which is prohibited, in principle, by Articles 49 and 56 EC respectively.

The ECJ accepted the justifications put forward by the Netherlands, i.e. that legislation such as Article 16(4) of the AWR contributes to the effectiveness of fiscal supervision and to the prevention of tax evasion. As to whether those restrictive measures comply with the principle of proportionality, the ECJ drew a clear distinction between on the one hand, the situation where items which are taxable in one Member State and located in another Member State have been concealed from the tax authorities of the first Member State and the latter does not have any evidence of the existence of those items which would enable an investigation to be initiated, and, on the other, the situation where the latter had such an evidence. When the tax authorities of a Member State had evidence enabling them to request the competent authorities of other Member States, whether by way of the mutual assistance provided for in the Mutual Assistance Directive or under bilateral conventions, to communicate to them the information necessary to establish the correct amount of tax due, the mere fact that the taxable items concerned are located in another Member State does not justify the general application of an additional recovery period which is in no way based on the time required to have effective recourse to those mechanisms of mutual assistance.

The ECJ therefore concluded that Articles 49 and 56 EC do not preclude the application by a Member State of a longer recovery period (and proportionally larger fine) in the case of assets held in another Member State than in the case of assets held in the first Member State when the assets and income in question have been concealed from the tax authorities of the first Member State and those authorities had no evidence of their existence enabling an investigation to be initiated. The fact that the other Member State applies banking secrecy is not relevant in that regard.

## **ECJ holds Netherlands withholding tax on outbound dividends paid to companies established in EEA countries incompatible with EC law (*Commission v Netherlands*)**

On 11 June 2009, the ECJ rendered its judgment in the *Commission v Netherlands* case (C-521/07). The ECJ concluded that, by not exempting dividends paid by Netherlands companies to companies established in Iceland or Norway from deduction at source of the tax on dividends under the same conditions as dividends paid to Netherlands companies or companies of other Member States, the Netherlands failed to fulfil its obligations under Article 40 EEA.

On 18 October 2005, the Commission sent a letter of formal notice to the Netherlands, requesting explanations concerning the taxation of outbound dividends. On 6 July 2006, the Commission issued a reasoned opinion, setting out the same complaints and calling upon the Netherlands to take the necessary compliance measures within a time-limit of two months. The Netherlands replied by letter of 7 September 2006 that the Dividend Withholding Tax Act (*Wet op de Dividendbelasting: 'Dwta'*) of 23 December 1965 would be adapted as from 1 January 2007, as regards dividends paid to companies established in one of the other Member States. That amendment led to the adoption of Article 4(2) of the DWTA. By contrast, the Netherlands maintained, as regards the alleged infringement of Article 40 EEA, that the Netherlands legislation concerned did not constitute an obstacle to the free movement of capital, and that, even if it did, this was a justified obstacle.

Articles 4 and 4a of the DWTA, in conjunction with Article 13 of the Corporate Income Tax Act (*Wet op de Vennootschapsbelasting*) of 1969 provide for exemption from deduction at source of the tax on dividends for beneficiary companies having their seat in a Member State. In accordance with Article 4(2)2 of the DWTA, that exemption applies to dividends distributed to companies having their seat in another Member State which hold shares representing at least 5% of the paid-up nominal capital of the resident distributing company. By contrast, on the basis of the agreements for the avoidance of double taxation which the Netherlands has concluded with Iceland and Norway, which are EEA countries, exemption from deduction at source of the tax on dividends cannot be applied to dividends distributed to Icelandic or Norwegian companies unless the latter hold at least, 10% or 25% respectively of the shares of the distributing Netherlands company. Thus, unlike companies having their seat in a Member State, those companies are not protected against the risk of double taxation when they hold more than 5%, but less than 10% or 25% respectively, of the shares of the distributing Netherlands company.

According to the ECJ, such a difference in treatment as regards the method of taxing dividends paid to beneficiary companies established in Iceland and Norway, compared with those paid to beneficiary companies established in the Member States is likely to deter companies established in the former two States from making investments in the Netherlands. Moreover, it makes it more difficult for a Netherlands company to raise capital from Iceland and Norway than from the Netherlands or another Member State of the Community. It thus constitutes a restriction on the free movement of capital which, in principle, is prohibited by Article 40 EEA. In the light of its judgment in the *Ospelt en Schlössle Weissenberg* case (C-452/01), Article 40 and Annex XII EEA have the same legal scope as Article 56 EC.

The ECJ rejected the argument put forward by the Netherlands that beneficiary companies established in a Member State and beneficiary companies established in Iceland and Norway are not in comparable situations, stating that there is no binding rule enabling it to obtain information to verify whether the conditions laid down by Article 4(2) of the DWTA are fulfilled since the Mutual Assistance Directive does not apply to EEA countries.

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## **ECJ considers Finnish dividend tax withheld on dividends distributed to a Luxembourg SICAV in breach of EC law (*Aberdeen*)**

On 18 June 2009, the ECJ issued its long anticipated judgment in the *Aberdeen* case (C-303/07). A Luxembourg SICAV, Aberdeen Property Nordic Fund I SICAV, received dividends from a Finnish non-quoted company, Aberdeen Property Fininvest Alpha Oy ('Alpha'). Finnish dividend tax was withheld on these distributions.

Alpha applied to the Finnish Central Tax Board for an exemption from the dividends

withholding tax on the basis of (i) application of the Parent-Subsidiary Directive and (ii) application of freedom of establishment and/or the free movement of capital. Alpha argued that a difference in treatment existed between a Finnish limited liability company or a Finnish investment fund receiving a dividend from a Finnish source, which is exempt from Finnish dividend withholding tax, as these dividends are exempt from Finnish corporation tax, and a Luxembourg SICAV which was subject to Finnish dividend withholding tax. Therefore, this difference in treatment between a domestic and a foreign shareholder was incompatible with Articles 43 and 56 EC.

The Finnish Central Tax Board rejected this claim based on the fact that (i) a Luxembourg SICAV is not mentioned in the annex to the Directive, and does not pay corporate income tax in Luxembourg; and (ii) it is not objectively comparable to a Finnish limited liability company or a Finnish investment fund. Alpha challenged this decision before the Finnish Supreme Administrative Court (*Korkein hallinto-oikeus, KHO*) which, in turn, referred the case to the ECJ for a preliminary ruling, asking in essence whether a Luxembourg SICAV is objectively comparable with a Finnish limited liability company or a Finnish investment fund.

The ECJ first pointed out that the Parent-Subsidiary Directive did not apply in the current case, in view of the fact that the SICAV does not meet its requirements. Subsequently, the ECJ decided to investigate whether there was a violation of the freedom of establishment of Articles 43 and 48 EC.

The ECJ noted that a stock company or investment fund, governed by Finnish law and resident in Finland, receiving dividends from another company and having its seat in Finland is, in principle, exempt from tax on those dividends. In contrast, dividends distributed by a resident company to a non-resident company are, in principle, subject to withholding tax. This means that, according to the ECJ, a non-resident recipient company is subject to taxation on those dividends at two levels (multi-tier taxation) in so far as (i) the Finnish company distributing the dividend is taxed on its profits; and (ii) the withholding tax is withheld for the account of the dividend recipient. No such taxation at two different levels is present for dividends received by a Finnish resident share company or investment fund.

The ECJ considered that this difference in treatment constitutes a restriction of the freedom of establishment. Such difference in treatment is not permissible if the foreign and domestic shareholders are *comparable*. Therefore, further to its decision in, inter alia, *Amurta* (C-379/05), the ECJ confirmed that once a Member State, unilaterally or by way of a double tax treaty, imposes income tax not only on resident shareholders but also on non-resident shareholders in respect of dividends which they receive from a resident company, the position of those non-resident shareholders becomes *comparable* to that of resident shareholders.

Consequently, the ECJ stated that where a Member State has chosen to relieve resident parent companies from (withholding) tax on the profits distributed by a resident subsidiary, it must extend that relief to non-resident parent companies which are in a *comparable* situation. The ECJ explicitly confirmed that a Luxembourg SICAV is comparable to a Finnish company, as Finland imposes a charge of income tax on the Luxembourg SICAV for the dividends received, and noted that (i) legal differences between domestic and foreign entities, and (ii) non-taxation of the dividends in the home State Luxembourg are not relevant.

It follows from the decision that comparability does not mean that the foreign dividend recipient must be identical to a domestic recipient from a legal, regulatory or tax perspective. Finally, the ECJ did not consider a justification ground present with respect to the restriction of the freedom of establishment. Therefore, the ECJ concluded that the Finnish legislation is in breach of EC law.

#### *Preliminary comments*

The decision of the ECJ implies that dividend (withholding) tax levied by several Member States from investment funds resident in other Member States is often levied in breach of EC law. Our European wide EU Tax Law Group has investigated this matter and has determined that many Member States impose dividend tax in a cross-border situation, whereas an exemption of dividend tax or refund is granted in the domestic situation. This difference in treatment is, in principle, forbidden if the foreign recipient of the dividend is objectively comparable to the domestic recipient and if no justification ground applies and no (full) credit is received.

The ECJ has again confirmed in the *Aberdeen* case that once a Member State imposes

a charge of income tax not only on resident shareholders but also on non-resident shareholders in respect of dividends which they receive from a resident company, the position of those non-resident shareholders becomes comparable to that of resident shareholders.

This could mean that investment funds, pension funds, insurance companies, banks etc. are objectively comparable across Europe if they are subject to (withholding) tax on dividends received from companies in other Member States. Please note, however, that as a result of the fact that neither a Finnish investment fund nor a Finnish limited liability company is subject to Finnish corporate income tax, the matter of comparability was in a sense not difficult to establish. The question of comparability would have been more interesting had the comparison only been made between a Finnish investment fund and a Luxembourg SICAV. Now the ECJ seems to settle by leaving aside the comparison between a Finnish company and a SICAV. Another interesting question is what would have happened if one of the two types of Finnish entities were exempt from withholding tax and the other subject to withholding tax. In other words, in that situation, should the comparison be between the SICAV and the exempt entity or between the SICAV and the taxed entity? Such questions are still open to debate.

In conclusion, it would be wise for investment funds, pension funds, insurance companies, banks across Europe to safeguard their rights in all relevant jurisdictions as soon as possible, by filing requests for a refund or exemption from dividend tax. Statutes of limitation have to be taken into account.

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### **ECJ rules restricted imputation of foreign withholding tax on dividends received by Belgian individual residents from EU companies compatible with EC law (*Damseaux*)**

On 16 July 2009, the ECJ ruled in *Damseaux* (C-128/08) that Article 56 EC does not preclude the France-Belgium tax treaty under which dividends distributed by a company established in France to an individual shareholder in Belgium are liable to be taxed both in France and in Belgium, and which does not provide that Belgium is unconditionally obliged to prevent the resulting juridical double taxation.

*Damseaux*, an individual Belgian resident, received dividends from a French company. In France, the dividends were subject to 15% withholding tax. The amount of the dividends remaining after that taxation was also subject to 15% withholding tax in Belgium. The France-Belgium tax treaty provides that Belgian residents may obtain the deduction of a fixed percentage or a tax credit for the French withholding tax paid at the rate and in accordance with the rules set out in the Belgian legislation for dividends distributed by Belgian resident companies. However, Belgian legislation no longer provides for the procedure of setting off the fixed percentage nor for a tax credit. Hence, dividends distributed by French companies to a Belgian resident shareholder are subject to juridical double taxation, whereas dividends distributed by Belgian companies to a Belgian resident shareholder are only subject to 15% Belgian withholding tax.

The ECJ ruled that dividends distributed by a company established in one Member State to a shareholder residing in another Member State are liable to be subject to juridical double taxation as a result of the parallel exercise of tax competences by two different Member States. The ECJ referred to its decisions in *Kerckhaert and Morres* (C-513/04) and *Orange European Smallcap Fund* (C-194/06) where it decided that any disadvantages that could arise from this parallel exercise of tax competences do not constitute restrictions prohibited by the EC Treaty, provided that the parallel exercise is not discriminatory. Furthermore, the ECJ reminded that in the area of direct taxation, no unifying or harmonising measures designed to eliminate double taxation (other than the Parent-Subsidiary Directive and the Savings Directive) have yet been adopted at Community level. Hence, it is for the Member States to define the criteria for allocating their powers of taxation and to take the measures necessary to prevent double taxation. In its current state and in a situation as such at issue, EC law does not lay down any criteria for the attribution of areas of competence between Member States. Consequently, the ECJ decided that, in its current status and in a situation as such at issue, Article 56 EC does not preclude the France-Belgium tax treaty which allows juridical double taxation of dividends distributed by French companies to Belgian resident shareholders.

## **ECJ strikes down German provisions on savings-pension bonus (*Commission v Germany*)**

On 10 September 2009, the ECJ rendered its judgment in the *Commission v Germany* case (C-269/07), regarding the compatibility with Articles 12, 18 and 39(2) EC, and of Article 7(2) of Council Regulation (EEC) No 1612/68 of 15 October 1968 on the freedom of movement for workers, of German income tax provisions which were adopted in order to encourage the establishment of private pensions, commonly referred to as 'Riester pensions' or 'Riesterrente'.

The Commission challenged three aspects of the Riester pension legislation, in so far as those provisions:

- deny cross-border workers (and their spouses) the right to an allowance, unless they are fully liable to tax;
- do not permit the capital advanced to be used for an apartment serving as the recipient's own residence in the recipient's own dwelling, unless that dwelling is in Germany;
- require the repayment of financial support on termination of liability to unlimited taxation.

The ECJ generally followed Advocate General Mazák's Opinion of 31 March 2009 (see EU Tax Alert, edition 66, May 2009) and concluded that the savings-pension bonus in question should be regarded as a social advantage generally granted to workers on the basis of their objective status as workers within the terms of Article 7(2) of Council Regulation (EEC) No 1612/68. It aims at ensuring that retired persons have an adequate pension at the end of their professional lives, regardless of the fact that such savings-pension contracts are concluded with a private provider and that the resultant payments into that scheme are clearly of a voluntary nature.

The ECJ considered that the requirement that a cross-border worker (and his spouse) be fully liable to tax in Germany in order to benefit from the supplement to the savings-pension bonus constitutes indirect discrimination and infringes Article 39(2) EC and Article 7(2) of Council Regulation (EEC) No 1612/68, as such requirement can more easily be met by German workers than by cross-border workers from other Member States. According to the ECJ, the fact that cross-border workers may possibly be able to obtain tax reductions in their State of residence does not put an end to the discrimination to which they are subject as regards the grant of the savings-pension bonus. The ECJ rejected the justifications proposed by Germany, based on fiscal coherence.

In addition, the Court reached the same conclusion with respect to German provisions which prevent cross-border workers from using the subsidised capital of their savings-pension to build or purchase a dwelling for their own occupation in the territory of their residence, because the property is situated outside Germany. The ECJ rejected the justifications proposed by Germany, based on protection of public interest (i.e. ensuring an adequate supply of housing) and preservation of its social security system.

Finally, the ECJ considered that the obligation to reimburse the savings-pension bonus upon termination of unlimited tax liability restricts the exercise of the right of free movement pursuant to Article 39 EC and Article 7(2) of Council Regulation (EEC) No 1612/68 of German workers as it has a dissuasive effect on those wishing to work in another Member State. In the Court's view, Germany cannot rely on the fact that subsequent payments under the savings-pension contracts are not taxed there when workers leave the country. That fact is irrelevant since the competence to tax those payments has been granted to other Member States pursuant to bilateral conventions to prevent double taxation concluded between those Member States and Germany, as acknowledged by the latter. Moreover, the fact that for workers who remain in Germany, taxation of the payments arises, as the case may be, only after several decades is not comparable to the obligation to reimburse on termination of full liability to German tax which applies to those who leave Germany. The ECJ also rejected the justification based on fiscal cohesion and upheld that the same conclusion applies in respect of persons who are not economically active, for the same reasons, representing an infringement of the freedom of movement granted to citizens of the Union pursuant to Article 18 EC.

## **ECJ holds German legislation disallowing write-down on participations acquired from non-residents compatible with free movement of capital (*Glaxo Wellcome*)**

On 17 September 2009, the ECJ rendered its decision in the *Glaxo Wellcome* case (C-182/08), generally following Advocate General Bot's Opinion of 9 July 2009 (see EU Tax Alert, edition no. 69, August 2009). On 23 January 2008, the German Federal Tax Court decided to refer this case to the ECJ for a preliminary ruling. The question put to the ECJ was whether the German legislation disallowing the deduction from the taxable base of losses arising from a write-down on the value of participations acquired from non-resident persons, while allowing such a deduction in respect of participations acquired from resident persons, infringed the freedom of establishment and/or the free capital movement protected under Articles 43 and 56 EC, respectively.

This case concerns a complex restructuring of the Glaxo Wellcome group, which took place in June and July 1995. It involved companies established in Germany (Glaxo Verwaltungs GmbH and Glaxo Wellcome GmbH) which acquired participations in other German companies (Glaxo Wellcome GmbH and Wellcome GmbH) from United Kingdom companies of the same group (Glaxo Group Limited and Burroughs Wellcome Ltd). Glaxo Wellcome GmbH & Co KG ('Glaxo Wellcome') is a limited partnership established in Germany, resulting from the merger of Glaxo Wellcome GmbH and Wellcome GmbH in August 1995, with retroactive effect to June 1995. This case specifically refers to its taxable profits in the fiscal years 1995 to 1998. Under the applicable German legislation, Glaxo Wellcome was disallowed to deduct from its taxable base losses arising from a write-down on the value of participations in German companies of the group because such participations had been acquired from UK parent companies (so-called 'blocked amounts'). Had those participations been acquired from German residents, Glaxo Wellcome would have been allowed such write-down.

Under the 'full imputation' taxation system in force in Germany at the material time, double economic taxation of the profits distributed by companies established in Germany to German resident taxpayers was avoided by giving those taxpayers the right to offset in full the corporation tax paid by the distributing companies against their own income tax or corporation tax liability. No credit was allowed with respect to capital gains. Instead, the economic double taxation upon a transfer of shares was mitigated by allowing the purchaser of the shares to devalue its shareholding upon a dividend distribution from the acquired subsidiary. Hence, the German tax legislation placed the relief for economic double taxation at the wrong level (purchaser instead of seller). The market corrected this legislative flaw by including the tax benefit in the shares' selling price. Consequently, through this alternative route the seller still (materially) obtained his 'credit' at the end of the day.

Under the German imputation system at dispute, the loss in value of shares resulting from a profit distribution by a resident company is taken into account when the shares have been acquired from a person entitled to the imputation credit (i.e. a German resident), but not when they were acquired from a person not entitled to such a credit (i.e. non-resident in Germany). Adversely, Germany has no sovereign powers to tax capital gains derived by non-residents. This anti-avoidance provision was intentionally inserted by the German legislature to prevent non-resident persons from benefiting from this credit, e.g. via an intra-group transaction whereby a non-resident parent company transfers its participation in a German company to a related German company which is entitled to the credit. Despite the apparent objective of capturing intra-group transactions set up with the purpose of materially benefiting from the credit, the scope of application of the disputed German legislation also covered transactions between unrelated parties.

Pursuant to Article XVIII(1) of the 1964 Germany-UK tax treaty, a UK resident is entitled to the imputation credit when it controls directly or indirectly at least 25% of the voting power in a German company. However, this treaty provision was not applicable to the present case because the participations held by and acquired from the UK parent companies did not reach the minimum 25% threshold.

In the light of the circumstances of this case and the objective of the German legislation, the ECJ concluded that the free movement of capital is the only fundamental freedom applicable. The Court further observed that the German

legislation imposed a restriction on the exercise of the free movement of capital which is prohibited, in principle, under Article 56 EC. Concurring with Advocate General Bot, the ECJ noted that shareholders that acquire shares from a resident or from a non-resident person are in a comparable situation with regard to the losses resulting from a reduction in value of the shares held in a resident company. The distribution of profits reduces the value of a share, whether it was previously acquired from a resident or a non-resident, and in both cases, that reduction in value is borne by the resident shareholder.

As recommended by the Advocate General, the ECJ rejected the justification presented by the German government based on fiscal coherence of the German system, but accepted the justification based on the need to prevent tax evasion and abuse. Moreover, following the territoriality principle, the Court held that the German legislation at issue can be justified by the need to maintain a balanced allocation of the power to impose taxes between the Member States. Since the price of the shares includes an amount equal to the tax credit, the grant of a tax credit or the refund of an amount equal to that tax credit to Glaxo Wellcome would result in indirectly granting its non-resident shareholders a financial advantage equal to the tax credit for the tax charged on the profits of a resident company, without Germany being able to tax former non-resident shareholders on the realized capital gains. It follows that the profits normally taxable in that company's Member State of residence (here: Germany) would be transferred to the Member State with jurisdiction to tax the profits made by the non-residents (here: the UK), thus jeopardising a balanced allocation of the power to impose taxes between the Member States. The ECJ left up to the national court the analyses of the proportionality of such a restrictive measure.

Therefore, the ECJ concluded that the domestic legislation of a Member State which excludes the reduction in value of shares as a result of the distribution of dividends from the basis of assessment for a resident taxpayer, where that taxpayer has acquired shares in a resident capital company from a non-resident shareholder, is compatible with the free movement of capital (Article 56 EC), subject to the condition that such legislation does not exceed what is necessary to maintain a balanced allocation of the power to impose taxes between the Member States and to prevent wholly artificial arrangements which do not reflect economic reality and whose only purpose is to obtain unduly a tax advantage. It is now for the national court to examine whether the legislation at issue in the main proceedings is limited to what is necessary in order to attain those objectives and to decide whether the German legislation at dispute is indeed appropriate to counteract tax evasion and abuse and guarantee the balanced allocation of taxing powers between Germany and the UK, thus disallowing Glaxo Wellcome to deduct from its taxable base losses arising from a write-down on the value of participations in German companies of the group because such participations were acquired from UK parent companies.

#### *Preliminary comments*

According to ECJ's ruling in the *Test Claimants in Class IV of the ACT Group Litigation* case (C-374/04), residents and non-residents are not in a comparable situation, but this only as long as a Member State does not exercise its taxing powers on the foreigner receiving the respective income items. However, the reasoning derived from the *Test Claimants in Class IV of the ACT Group Litigation* decision does not hold true in the case at hand, since Germany only exercises its taxing powers with respect to capital gains derived by resident taxpayers. An alternative solution for Germany would have been to grant a credit for the corporate tax on capital gains realized, but this only with respect to persons who are taxed in Germany on the gains realized. In that event, the ECJ's ruling in the *Test Claimants in Class IV of the ACT Group Litigation* case would have allowed Germany to deny the credit to non-resident shareholders, as long as Germany abstained from exercising its taxing powers with respect to capital gains derived by non-resident taxpayers.

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### **ECJ concludes German rules restricting the scope of Parent-Subsidiary Directive to legal forms explicitly included in its Annex compatible with EC law (*Gaz de France*)**

On 1 October 2009, the ECJ rendered its decision in the *Gaz de France* case (C-247/08), regarding the interpretation of the Parent-Subsidiary Directive. This case, referred to the ECJ by the German Tax Court of Cologne, concerns a dividend distribution made in 1999 by a German GmbH to its French parent company which, until 2002, had the legal form of a *société par actions simplifiée* ('SAS'). In 1999, the

dividend distribution was subject to German withholding tax at a rate of 5%, as well as a solidarity surcharge. The French company requested a refund of the German withholding tax. This request was dismissed by the German tax authorities on the ground that at the time, the legal form of an SAS was not included in the list of qualifying companies in the Annex to the Parent-Subsidiary Directive.

This grammatical interpretation of the Parent-Subsidiary Directive was put into question by the Finance Court in Cologne, which requested the ECJ to answer the following questions:

1. whether an SAS, which was introduced into French law only in 1994, may be considered to be a 'company of a Member State' within the meaning of Article 2 (a) of the Parent-Subsidiary Directive, even though at the material time of the main proceedings, in 1999, it was not (yet) expressly listed in paragraph (f) of the Annex thereto; and
2. if not, whether Article 2(a) of the Parent-Subsidiary Directive in conjunction with paragraph (f) of the Annex thereto complies with Articles 43 and 48 EC or with Article 56(1), 58(1)(a) and 3 EC if, in conjunction with Article 5(1) of the Parent-Subsidiary Directive, Article 2(a) establishes, in the event of a profit distribution by a German subsidiary, an exemption from withholding tax for French parent companies taking the legal form of an SA, a '*société en commandite par actions*' or a '*société à responsabilité limitée*', but not for French parent companies taking the legal form of an SAS.

Following Advocate General Mazák's Opinion of 25 June 2009 (see EU Tax Alert, edition no. 68, July 2009), the ECJ adhered to a literal interpretation of the Parent-Subsidiary Directive and answered the first question in the negative. The Court admitted that an analogical interpretation would be in line with the Parent-Subsidiary Directive's objective to ensure the tax neutrality of the distribution of profits by a subsidiary established in one Member State to its parent company established in another Member State. Nevertheless, the ECJ also observed that the Parent-Subsidiary Directive does not seek to introduce a common system for all companies of the Member States nor for all holdings. Instead, it is for the Member States to determine whether and to what extent economic double taxation of dividends is to be avoided for holdings which do not fall within the scope of the Parent-Subsidiary Directive and, for that purpose, to establish, either unilaterally or through conventions concluded with other Member States, procedures intended to prevent or mitigate such economic double taxation.

According to the ECJ, the fundamental principle of legal certainty precludes the list of companies in point (f) of the Annex to the Parent-Subsidiary Directive from being interpreted as merely an indicative list, when such an interpretation does not follow from the wording or scheme of the Parent-Subsidiary Directive. Therefore, since the legal forms under French law are listed exhaustively in point (f) of the Annex to the Parent-Subsidiary Directive, the extension of its scope by analogy to other forms of company such as, for example, the French SAS, would not be admissible even if they were comparable to other types of company specifically mentioned therein.

With regard to the second question, the ECJ concluded that a restriction of the scope of the Parent-Subsidiary Directive which excludes from the outset other companies which may be created under national law, as is the case with Article 2(a) and point (f) of the annex thereto, is not apt to create a restriction either on the freedom of establishment or on the free movement of capital. Therefore, the ECJ also answered the second question in the negative.

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### **ECJ holds German legislation on deductibility of losses from letting or leasing of immovable property incompatible with EC law (*Grundstücksgemeinschaft Busley/Cibrian*)**

On 15 October 2009, the ECJ rendered its judgement in the *Grundstücksgemeinschaft Busley/Cibrian* case (C-35/08), following the German Tax Court of Baden-Württemberg's request for a preliminary ruling on 31 January 2008 (see EU Tax Alert, edition no. 55, May 2008). This case was decided without the Opinion of Advocate General Sharpston.

Ms Busley and Mr Cibrian Fernandez are siblings and Spanish nationals who have been resident in Germany since birth. In the period from 1997 to 2003, they received

income from employment and were liable to tax in Germany on the whole of their income. In 1990, the applicants' parents – also Spanish nationals – started to build a house in Spain, which was completed in 1993. The applicants' mother and father died in 1995 and 1996, respectively. On their father's death in November 1996, the applicants became proprietors of that house in their capacity as joint heirs (*Erbengemeinschaft*), but never lived there. The house was let from 1 January 2001 and sold in 2006.

In their tax returns submitted to the German tax administration for the period from 1997 to 2003, the applicants requested (i) that the decreasing-balance method of depreciation provided for in Paragraph 7(5) of the Law on Income Tax (*Einkommensteuergesetz*), as applicable in the period from 1997 to 2003 (the 'EStG'), be applied to the house in question, and (ii) that the limited offsetting of losses provided for at point 6(a) of the first sentence of Paragraph 2a(1) of the EStG not be applied. The German tax administration rejected those requests and applied the latter provision, together with the straight-line method of depreciation provided for in Paragraph 7(4) of the EStG, on the ground that the house in question was not situated in Germany. The applicants therefore brought an action before the referring court, claiming that the tax treatment of the income from their house in Spain infringed Articles 39 and 43 EC. The referring court took the view that this action could not succeed under German law, since the house in question was not situated in Germany. However, it had doubts as to the compatibility with Article 56 EC, and of Paragraph 2a(1), first sentence, point 6(a), and Paragraph 7(5) of the EStG, and decided to refer the matter to the ECJ for a preliminary ruling.

The ECJ noted that a situation in which natural persons residing in Germany and liable to unlimited taxation in that Member State inherit a house situated in Spain falls within the scope of Article 56 EC. It is therefore not necessary to consider whether Articles 39 and 43 EC apply, as argued by the applicants in the main proceedings. The ECJ observed that, for the purposes of establishing the basis of assessment for income tax for a taxable person in Germany, the losses incurred in respect of the income from, *inter alia*, the letting of an immovable property situated in Germany can be taken into account in full in the year in which they arise, whereas rental losses from an immovable property situated outside Germany are deductible only from subsequent positive income derived from letting that property (Paragraph 2a(1), first sentence, point 6(a) of the EStG).

Furthermore, a person who is liable to tax in Germany can apply the decreasing-balance method of depreciation to an immovable property situated in Germany (Paragraph 7(5) of the EStG) whereas only the straight-line method of depreciation is applicable to immovable property situated outside Germany (Paragraph 7(4), first sentence, point 2 of the EStG). The decreasing-balance method of depreciation has the effect of deferring taxation by bringing forward depreciation being liable to result, in the early years, in a rental loss figure that is considerably higher and, in consequence, in a considerably lower tax burden for that person (i.e. creating a cash-flow advantage) than those resulting from the straight-line method of depreciation. It follows that the German tax legislation at dispute imposes a restriction on the exercise of the free movement of capital since the tax position of a natural person residing and liable to unlimited taxation in Germany who, like the applicants in the main proceedings, has an immovable property in another Member State, is less favourable than it would be if that property were situated in Germany.

The ECJ rejected the justifications presented by Germany, based on the principle of territoriality and the socio-political objective of promoting the development of the German immovable property market. The Court held that Article 56 EC precludes the income tax legislation of a Member State under which individuals who are resident and liable to unlimited taxation are entitled to have (i) losses from the letting or leasing of an immovable property deducted from the taxable amount in the year in which those losses arise, and (ii) the income from such property assessed on the basis of the application of the decreasing-balance method of depreciation, only if the property in question is situated on the territory of that Member State.

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### **ECJ holds Italian dividend withholding tax on intra-Community distributions incompatible with EC law (*Commission v Italy*)**

On 19 November 2009, the ECJ rendered its judgment in the *Commission v Italy* case (C-540/07), concerning the compatibility of the Italian dividend withholding tax with

the free movement of capital vis-à-vis Member States and EEA countries (Articles 56 EC and 40 EEA) and the freedom of establishment with respect to EEA countries (Article 31 EEA), since the Parent-Subsidiary Directive is not applicable to the latter.

In essence, the Commission criticized the fact of the dividends distributed by Italian companies to resident companies being subject to a lower tax burden when compared to dividends paid to companies established in other Member States or EEA countries. Under article 89(2) of *Testo unico delle imposte sui redditi* approved by Presidential Decree no. 917 of 22 December 1986 ('TUIR'), Italian companies are entitled to a 95% exemption on the dividends received and the remainder (5%) is taxed at 33%, resulting in an effective tax burden of 1.65%. Pursuant to article 27(3) of Presidential Decree no. 600 of 29 September 1973 ('DPR 600/73'), a 27% dividend withholding tax is levied from non-resident beneficiaries, and up to 4/9 of this tax can be reimbursed upon request, amounting to an effective tax burden of 15%. When a double tax treaty applies, the dividend withholding tax is partially reduced to 5% and 10%, but it is still higher than the taxation applicable to purely domestic situations.

Following Advocate General Kokott's Opinion of 16 July 2009 (see EU Tax Alert, edition no. 69, August 2009), the ECJ ruled that the difference in treatment between domestic and cross-border dividends created by the Italian dividend withholding tax represents a restriction to the free movement of capital within the EU, in violation of Article 56 EC. Against the argument put forward by the Italian government that double tax treaties neutralize the restriction imposed by the source State, the ECJ observed that the difference in treatment can only be neutralized by the resident State where the company receiving the dividends is established, when it imposes enough tax to absorb the ordinary credit resulting from the tax withheld at source. When the resident State does not tax the dividends or taxes them at a lower rate, the difference in treatment is not neutralized by the ordinary credit provided under a double tax treaty. Furthermore, the ECJ noted that this argument did not hold true in relation to dividends distributed to companies established in Slovenia since Italy had not concluded a treaty with that country.

The ECJ rejected all the justifications presented by Italy, based on fiscal coherence, allocation of taxing powers and risk of tax evasion or avoidance, and concluded that had Italy failed to fulfil its obligations under Article 56 EC by imposing a higher burden on companies residing in other Member States and receiving dividends from Italian companies. As to the dividends paid to EEA countries, the ECJ concluded that the violation of Articles 31 and 40 EEA imposed by the Italian legislation at issue must be regarded as justified for the overriding reason in the public interest concerning the fight against tax evasion, and as appropriate to ensure the realisation of the objective in question without going beyond what is necessary in order to attain it. The Court noted that the framework of cooperation between the competent authorities of the Member States established by the Mutual Assistance Directive does not exist with respect to a non-Member State (such as EEA countries) when the latter has not entered into any undertaking of mutual assistance. Italy has not signed a double tax treaty nor an exchange of information treaty with Liechtenstein and the double tax treaties concluded with Iceland and Norway do not contain provisions laying down an obligation to supply information.

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### **Advocate General analyses compatibility of the Netherlands merger exemption with Merger Directive (*Zwijnenburg*)**

On 16 July 2009, Advocate General Kokott issued her Opinion in the *Zwijnenburg* case (C-352/08). This case concerns the interpretation of the anti-abuse provision in the Merger Directive.

The case, which revolved around the transfer of an enterprise from father to son, can be summarized as follows. BV 1, a company owned by the father, leased a building to BV 2, a company indirectly owned by the son. The building leased to BV 2 formed a functional unity with a building already owned by BV 2. In order to integrate both businesses, BV 2 had the intention to transfer all its assets (including the building) to BV 1 in exchange for shares. At a later stage, the son would acquire the father's shares in BV 1. BV 2 applied for the merger exemption, i.e. roll-over relief with respect to the transfer of assets pursuant to the Dutch implementation of the Merger Directive, as well as for an exemption from real estate transfer tax with respect to the building. The tax authorities denied the requests of BV 2, stating that the merger exemption did not apply as the main motive of the transaction was the avoidance of

real estate transfer tax. As a result, BV 1 sold the building to BV 2 subject to real estate transfer tax.

The Dutch Supreme Court noted that it was unclear whether the denial of the application of the merger exemption was in accordance with the Merger Directive and decided to refer the preliminary question to the ECJ, i.e. whether Article 11(1)(a) of the Merger Directive, the anti-abuse provision, can be explained such that the facilities of the Merger Directive can be denied where a series of legal transactions is aimed at preventing the levying of a tax which falls outside of the scope of the Merger Directive.

The Advocate General first examined the term 'tax avoidance' in Article 11(1)(a) of the Merger Directive. According to her, the Dutch domestic courts had made an inappropriate distinction where they argued that the transaction at issue was effected for valid commercial reasons, i.e. the integration of the two buildings in a single business, but that the means of arriving at the end result, i.e. the transfer of assets, should be considered tax avoidance. According to the Advocate General, the fact that taxpayers can choose the most tax efficient legally permitted alternative for the implementation of valid commercial reasons cannot as such justify the presumption of tax avoidance.

Secondly, the Advocate General discussed whether the avoidance of real estate transfer tax falls within the scope of the Merger Directive. She pointed out that the wording of Article 11(1)(a) of the Merger Directive is not explicitly limited to corporate income tax. However, the context and object of the Directive should also be taken into account. The Merger Directive provides that a qualifying transfer of assets shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes. The Advocate General argued that since the tax base of the real estate transfer tax is the value of the transferred property, and not specifically the difference between the economic value and the tax value, the real estate transfer tax does not fall within the scope of (Article 11(1)(a) of) the Merger Directive.

Thirdly, the Advocate General considered whether the general abuse of rights doctrine may be applied in this case. According to the Advocate General, Article 11(1)(a) of the Merger Directive is a reflection of the general abuse of rights principle and as such, has an exhaustive effect. Allowing a general and somewhat vague legal principle to apply in addition to a clearly defined provision in the Merger Directive would, in the Advocate General's view, have a negative impact on the intended harmonisation and promote legal uncertainty in cases of restructuring of capital companies. Moreover, the Advocate General argued that even if combating the avoidance of real estate transfer tax were allowed under the abuse of rights principle, denying the roll-over relief for corporate income tax purposes would be disproportional. In such a case, the benefits of the Merger Directive could only be denied to the extent necessary to avoid potential tax evasion or even to out tax evasion which has already taken place.

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### **Advocate General concludes Belgian transfer pricing rules compatible with EC law (SGI)**

On 10 September 2009, Advocate General Kokott gave her Opinion in the *SGI* case (C-311/08) regarding the compatibility of the Belgian transfer pricing rules with Articles 43, 48 and 56 EC and, as appropriate, Article 12 EC.

Belgian tax law provides that exceptional or gratuitous (i.e. not at arm's length) benefits granted by a Belgian resident company to a non-resident company with which the Belgian company is, directly or indirectly, in a relationship of interdependence are automatically added to the taxable base of the Belgian company granting such benefits. However, exceptional or gratuitous benefits granted by a Belgian company to another Belgian company, with which the latter is directly or indirectly connected, in identical circumstances are not added to the taxable base of the Belgian company granting the benefits.

After having decided that in the case at hand, only the compatibility with the freedom of establishment should be examined, Advocate General Kokott concluded that the Belgian legislation did constitute a restriction to the freedom of establishment since

an exceptional or gratuitous advantage granted to a non-Belgian company is treated less favourably than such advantage granted to a Belgian company in identical circumstances. After all, the fact that an exceptional and gratuitous advantage is added to the taxable base if granted to a non-Belgian company may lead to double economic taxation. Although the procedure under the Arbitration Convention could be applied to avoid this double taxation, Advocate General Kokott concluded that this is an additional administrative burden in the hands of the taxpayer, as the procedure is only applicable upon request of the taxpayer. Moreover, the taxpayer needs to pre-finance the double taxation during the course of the procedure. In a domestic situation, however, the risk of double taxation is very remote since the advantage is not added to the taxable base of the company granting it if the advantage is taxed in the hands of the company receiving it. Hence, a restriction of the freedom of establishment exists.

However, the Advocate General stated that this restriction could be justified by the need to combat wholly artificial arrangements and to preserve the right of the Member States to levy taxes, provided that the Belgian legislation was proportionate and did not go beyond what is necessary to reach this goal. Since the specific provision of the Belgian legislation was indeed only aimed at wholly artificial arrangements and prevented Belgian profit from being drawn out of the Belgian taxable base and transferred to a non-Belgian company, Advocate General Kokott found that the Belgian legislation was proportionate and did not go beyond what is necessary to reach its goal. Hence, Articles 43 and 48 EC do not preclude the above Belgian legislation on transfer pricing rules.

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### **Advocate General Kokott accepts restriction of cross-border losses (*X Holding*)**

On 19 November 2009, Advocate General Kokott issued her Opinion in the proceedings before the ECJ in the *X Holding* case (C-337/08). According to the Advocate General, the Netherlands is not obliged to allow a cross-border fiscal unity for Dutch corporate income tax purposes for the sake of horizontal carry-over losses. The Advocate General does, however, leave open the possibility that other advantages of the fiscal unity do have to be allowed to Netherlands parent companies of foreign subsidiaries.

In 2003, X Holding BV, a company resident in the Netherlands, requested to be included in a fiscal unity for corporate income tax purposes with its subsidiary F, a company resident in Belgium. The Netherlands tax authorities refused the fiscal unity, since F does not meet the applicable requirements that it is either resident in the Netherlands for tax purposes, or that it has a permanent establishment in the Netherlands. According to X Holding BV, the refusal to allow a (cross-border) fiscal unity is incompatible with EC law.

According to the Advocate General, the fact that only domestic subsidiaries may be included in a fiscal unity whereas foreign subsidiaries cannot constitute, in principle, a restriction on the freedom of establishment (Article 43 in conjunction with Article 48 EC). With regard to the justification of this restriction, the Advocate General found the following:

- The refusal of a cross-border fiscal unity with the view to excluding cross-border loss relief is justified by safeguarding of the allocation of the power to impose taxes
- The refusal to allow (by refusal of cross-border fiscal unity) a fiscally neutral reorganisation and to transfer assets free of tax could also be justified by safeguarding of the allocation of the power to impose taxes, but the Netherlands rule must be suitable and necessary in order to achieve this object. The Advocate General leaves this up to the Dutch Supreme Court to decide.
- The Advocate General stated the same about the taxing of internal transactions as a consequence of the refusal of a cross-border fiscal unity.

#### *Preliminary comments*

The emphasis in the Advocate General's Opinion lies strongly on the question of whether it should be possible to set off losses of a foreign subsidiary against profits of a Netherlands parent company. By answering this question separately, apart from the other aspects of the fiscal unity mentioned, the Advocate General follows the approach taken in the recent case law of the Netherlands Supreme Court, whereby

the justification of the discrimination in the Netherlands fiscal unity legislation is tested element-for-element.

The Advocate General has now thus come to the conclusion that a fiscal unity may be refused in order to exclude cross-border loss relief. In the 'element-for-element' approach, however, all other aspects of the fiscal unity will have to be tested separately – where necessary in new proceedings – as to whether they constitute a disproportionate restriction. This applies, for example, to the possibility already referred to by the Advocate General to carry through tax free reorganisations within the fiscal unity, but equally to the mitigating effect that the fiscal unity has on the interest deduction measures which were proposed in the Consultation Document of 15 June 2009.

Please note that the Advocate General's Opinion only represents an advice to the ECJ. The ECJ is not required to follow this advice. The ruling of the ECJ is expected in the first half of 2010.

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### **Commission refers Spain and Portugal to the ECJ on exit-taxes on companies**

On 8 October 2009, the Commission decided to refer Spain and Portugal to the ECJ over restrictive provisions on exit tax for their tax provisions which impose an exit tax on companies which cease to be tax resident in these countries, since the Spanish and Portuguese tax rules on exit taxes on companies were not amended to comply with the reasoned opinions sent to them in November 2008 (see EU Tax Alert, edition 61, December 2008).

Under Spanish law, when a Spanish company transfers its residence to another Member State or when a permanent establishment ceases its activities in Spain or transfers its Spanish located assets to another Member State, unrealised capital gains must be included in the taxable base of that financial year, whereas unrealised capital gains from purely domestic transactions are not included in the taxable base.

Under Portuguese law, in case of the transfer of seat and place of effective management of a Portuguese company to another Member State or in case a permanent establishment ceases its activities in Portugal or transfers its Portuguese located assets to another Member State

- the taxable base of that financial year will include any unrealised capital gains in respect of the company's assets whereas unrealised capital gains from purely domestic transactions are not included in the taxable base;
- the shareholders of the company that transfers its seat and place of effective management abroad are subject to tax on the difference between the company's net assets (valued at the time of the transfer at market prices) and the acquisition cost of their participation.

The Commission considered that such immediate taxation penalises those companies that wish to leave Portugal and Spain or to transfer assets abroad, as it results in less favourable treatment as compared to those companies which remain in the country or transfer assets domestically. The rules in question are therefore likely to dissuade companies from exercising their right of freedom of establishment and, as a result, constitute a restriction of Article 43 EC and Article 31 EEA.

The Commission's opinion is based on the EC Treaty as interpreted by the ECJ in its judgment of 11 March 2004, in *De Lasteyrie du Saillant* case (C-9/02), as well as on the Commission's Communication on exit taxation (COM(2006)825) of 19 December 2006.

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### **Commission refers the United Kingdom to the ECJ over improper implementation of the Marks & Spencer judgment on cross-border loss relief**

On 8 October 2009, the Commission decided to refer the United Kingdom to the ECJ for improper implementation of the ECJ ruling in Marks & Spencer on cross-border loss relief. The relevant UK legislation imposes conditions on cross-border group loss

relief which make it virtually impossible for tax payers to benefit from such relief. The relevant provisions are incompatible with the right of establishment provided for in Articles 43 and 48 EC and Articles 31 and 34 EEA.

In the Marks & Spencer ruling (case C-446/03) of 13 December 2005, the ECJ ruled that it is disproportionate to prohibit a UK parent company from deducting the losses of its non-resident subsidiary, when the latter has exhausted all possibilities for relief in its State of establishment. Following this ruling, the UK should in principle grant relief for definitive losses of a subsidiary established in another Member State.

However, although the legislation has been amended, the UK continues to impose conditions on cross-border group loss relief which in practice make it impossible or virtually impossible for the taxpayer to benefit from such relief in accordance with the judgment in Marks & Spencer. This in particular concerns the following aspects:

- An unnecessarily restrictive interpretation of the condition that there should be no possibility of use of the loss in the State of the subsidiary (paragraph 7 of Schedule 18A of the Income and Corporation Taxes Act (ICTA) 1988);
- The parent company should demonstrate that the condition that there should be no possibility of use of the loss in the State of the subsidiary is met as from immediately after the end of the accounting period in which the loss arises (Part 1, paragraph 7(4), of Schedule 18A ICTA 1988);
- the legislation states that it applies only to losses incurred after 1 April 2006 (Part 3 of Schedule 1 of the Finance Act 2006).

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### 3. VAT

#### **2010 is approaching, as is the VAT Package!**

##### *Introduction*

In recent editions of the EU Tax Alert, we have been informing you about the big changes that are to be made to EC VAT legislation, most of which will enter into force on 1 January 2010. Those changes, combined in the 'VAT Package', will have a major impact on companies in the EU. With year 2010 drawing nigh, we should like to provide you an update on the VAT Package in this edition of EU Tax Alert.

First, we start by giving a brief outline of the background of the VAT Package. We then summarise the three pillars of the VAT package, and finally, conclude with some remarks about the implementation of the new rules in all Member States.

##### *Background*

After a lengthy period of preparation and discussion, the EU Ministers of Finance reached agreement on the VAT Package in December 2007. This package of amendments to the EC VAT legislation is embodied in two Directives, no. 2008/8/EC and no. 2008/9/EC, and one Regulation, no. 142/2008, all of which are dated 12 February 2008. The goals that underlie the amendments are as follows:

- simplifying rules for place of supply of services;
- removing differences between Member States in interpretation of VAT rules;
- banning as much as possible competition distortions;
- moving on with technological developments;
- modernizing and simplifying refund procedures for foreign VAT;
- promoting more administrative cooperation between Member States in the field of combating intra-Community VAT fraud.

Although the Commission was of the view that the rules had to be changed one of the principles, taxation of consumption in the country where the consumption takes place, has been adhered to and was used a guideline when drafting the amendments.

The content of the VAT Package is based on in three pillars. The first, and most important pillar, is the changes regarding the place of supply of services. The second is a new listing obligation for EU taxpayers that provide services to entrepreneurs in other Member States. The third is a new procedure for the refund of foreign EC VAT to EU taxpayers.

### *Change of rules regarding place of supply of services*

The changes regarding the place of supply introduce a distinction between services supplied to other taxpayers and services supplied to non-taxpayers. Under the current rules, the qualification of the recipient is of less importance for determining the place of supply of services. For services provided to non-taxpayers, the main rule remains that for VAT purposes, the service is deemed to take place in the country where the supplier of the service is established. Furthermore, the existing exceptions to that main rule will, in general, remain applicable. Only with respect to the long-term hiring of means of transport to non-taxpayers, is a change included in the amendments. Long-term hiring, a new concept in the VAT Package, which means the hiring of a means of transport for more than 30 days (or 90 days if it concerns a vessel), will be taxed in the country where the recipient is established, as of 2013.

With respect to the rules for the place of supply of services to taxpayers, the current main rule will be radically changed. Under the current main rule, services are taxed in the country where the supplier of the service is established. As of 1 January 2010, in principle, services rendered to other taxpayers will be taxed in the country where the recipient is established. This new rule is complemented by an extended reverse charge mechanism. That is, if a service supplier is not established in the country where the service is taxed and the recipient is a taxpayer established in that country, the VAT is mandatorily levied from the recipient of the service.

Noteworthy for some Member States it that the current 'force of attraction' rules may no longer be applied as from 2010. In that respect, the VAT Package determines that in the case a taxpayer has a permanent establishment in the other Member State where the services are deemed to have taken place, the permanent establishment is not deemed to have rendered the services if the permanent establishment does not intervene in the supply of the services. In short, if a permanent establishment is not involved in supplying the services, the new extended reverse charge mechanism will be applicable and no local VAT will be due.

Exceptions also apply to the new main rule regarding services to taxpayers, including:

- services relating to real estate: services take place where the real estate is located;
- short term hiring of means of transport: service takes place where the means of transport is made available;
- restaurant and catering services: services take place where the services are actually provided (in the case of on board an aircraft, vessel or train, the place of departure of the transport);
- passenger transport: service takes place where the transport actually takes place, in proportion to the distance covered;
- cultural, artistic, sportive, scientific, educational and similar services: services take place where the activity is actually performed (as of 2011, service of admission to such events will take place according to the new main rule).

Due to the increasing distinction between the rules for services to taxpayers and non-taxpayers, it has become more important to determine the status of the recipient of the services. In that respect, the new rules determine that if a legal person is registered for VAT purposes, regardless of the fact of whether or not this is correct, the legal person qualifies for determining the place of supply of services as taxpayer. Furthermore, the purposes for which the taxpayer acquires the services, taxable or non-taxable activities, are not decisive. Consequently, a taxpayer acquiring services is deemed to act as a taxpayer even if the services are acquired for non-taxable activities.

Special attention has to be drawn to the new and extended 'actual-use-and-enjoyment' rule. This rule, already applicable with a limited coverage under current legislation, is a possibility for Member States to tax services which, under the main rules, would not be taxed in that Member State but which are effectively used or enjoyed in the Member State. This possibility can be used to prevent non-taxation or distortion of competition and may only be applied to services which would be taxed under the main rules in a country outside the EU. On the other hand, when services are taxed with VAT in a Member State but the effective use and enjoyment is outside the EU, Member States can determine that no VAT will be levied. Both rules are a possibility for Member States and it will be up to the discretion of all Member States to determine if, and if so to what extent and under what conditions this rule will apply. This makes it difficult to estimate what the impact of this rule will in the EU.

### *New listing obligation*

Due to the change of the main rule for services supplied to taxpayers and the complementing reverse charge mechanism, no actual VAT will be due on the majority of internationally supplied services. In order to be able to monitor a correct application of the VAT rules for services, a new administrative obligation is created, a listing for intra-EU services. As of 2010, taxpayers rendering services to taxpayers in other Member States, and for which the new main rule will be applicable, have to file a list containing all VAT numbers of their EU customers accompanied by the amount for which the customer received services in a certain period. In principle, taxpayers have to file the listing, which is comparable to the already existing listing for intra-Community supply of goods, on a monthly basis. However, Member States may allow taxpayers, under certain conditions, to file the sales listing on a quarterly basis.

An issue that might lead to problems for taxpayers is that if a service is exempted (with or without right to refund) in the Member State of the recipient, the turnover of that service does not have to be listed. Due to the fact that VAT exemptions are not interpreted in the same way in all Member States and Member States can have, by way of derogation, exemptions applicable only in their Member State, it is, in principle, up to the service suppliers to investigate whether or not the services they have supplied are exempt in other Member States. This will certainly lead to mismatches at the beginning when service suppliers list all their rendered services and recipients do not declare any VAT due to the applicability of an exemption.

The information from all listings received by the tax authorities in the various Member States is subject to the automatic exchange of information between Member States. This is already the case for the listings of supplies of goods and, therefore, can be used to investigate if the receivers of services themselves correctly declare the VAT due. Although an automatic exchange of information has been agreed upon between Member States, this is not always adhered to in practice. This seems to be a result of the demanding IT needs that the automatic exchange of information requires. It goes without saying that expanding the listing of sales with services will not enhance a proper operation of the system. In this respect, however, we note that the system of exchanging information in the field of EC VAT is also to be amended separate from the VAT Package (for more details, see below '*Commission proposes measures in the field of administrative cooperation for combating tax fraud*' in this edition of the EU Tax Alert).

### *Refund of foreign VAT in the EU*

Finally, the VAT Package also foresees in an, at least apparent, administrative relief. As of 2010, EU taxpayers will be relieved from requesting refunds of foreign EC VAT by filing paper requests with each separate foreign tax authority. The refunds of EC VAT of all Member States in which an EU taxpayer is not established, can be requested by filing the request through an electronic portal of the tax authority of its own Member State. This authority will transmit the requests to all the respective Member States. The other Member States themselves will continue to deal with the requests. This is contrary to media publications throughout the EU in the past months. According to various media, the Member State of establishment will refund foreign VAT, which, obviously, is not the case. On the other hand, the new procedure is a form of relief, given that it dispenses with a mass of paperwork. The requests have to be filed electronically and, in principle, the original invoices no longer have to be handed over to the foreign tax authorities.

Together with the new procedure, which in practice will be applicable to 2009 VAT that qualifies for a refund, the new rules include some more demands for Member States relating to handling the requests. For example, the time in which a refund request has to be lodged is narrowed to a maximum of eight months and, if a Member State is too late in the actual refunding of the VAT, that Member State will be due interest.

### *Implementation of new rules in national legislation*

Changes to EU legislation demand action of the national legislature and tax authorities. This is also the case with the VAT Package. Given that Regulation no. 142/2008 has direct effect in each Member States, those rules do not have to be implemented in the respective national legislation. This, however, is different for the new rules of Directive 2008/8/EEC and Directive 2008/9/EEC. According to Article 7 and Article 29 respectively of those Directives, all Member States must implement the rules by 1 January 2010 at the latest. Accordingly, the legislature of all 27 EU Member States are required to amend their VAT legislation.

To date, a relatively large number of Member States, about half, have not yet published the proposals to amend their national legislations. This course of affairs is undesirable from the viewpoint of legal security. This is even more cogent as regards possibilities for Member States to deviate from the standard rules, or to choose the extent to which some rules are to be implemented. An important example of such provision is the extended 'actual-use-and-enjoyment' rule. For instance, for multinationals with a purchasing organization outside the EU, which is no longer inconceivable, it is important to know which Member States would apply a 'use-and-enjoyment' rule as of 2010 that would affect services purchased by such organization.

Another interesting issue to follow is the interpretation by the various tax authorities of some concepts to be introduced, such as a short-term and long-term hiring of means of transport. Although the rules under the VAT package and the explanatory notes make no attempt to prevent different interpretations, contradictory interpretations can never be excluded. The VAT Package is, therefore, a potential breeding ground for new national and ECJ case law.

Recommended, from a practical point of view, is that Member States speed up the implementation process and inform taxpayers about the new administrative procedures for listing and refund requests. The new procedures require a raft of IT modification and expansion, and taxpayers need the time to change their reporting systems accordingly in order to be able to comply with the new rules as of 2010. In that respect, it is regrettable that the EU is not taking a more leading role in bringing Member States into line. One thing is certain, the VAT Package promises a few enervating months ahead for all concerned.

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### **ECJ holds VAT with respect to non-economic activities is not deductible (*VNLTO*)**

On 12 February 2009, the ECJ rendered its decision in the *VNLTO* case (C-515/07). *VNLTO* is an association that promotes the interests of the agricultural sector and the entrepreneurs who are active in this sector. Aside from these non-economic activities, *VNLTO* also provides a number of services to its members and third parties that are taxable for VAT purposes.

During the year 2000, *VNLTO* applied for a deduction of input VAT paid on the acquisition of goods and services, which partly related to the non-economic activities, on the basis that the costs could wholly be allocated to the taxable activities and that the non-economic activities could subsequently be regarded as having been performed 'for purposes other than those of his business' within the meaning of Article 6, second paragraph of the Sixth EC VAT Directive. The Dutch Supreme Court referred preliminary questions to the ECJ, because it was unsure whether *VNLTO* was allowed to allocate the non-capital goods and services to its economic activities, thereby enabling it to deduct all input VAT on these costs.

Following its decision in the *Securenta* case (C-437/06), in which the ECJ decided that the deduction of input VAT on costs was only allowed to the extent that those costs can be attributed to economic activities, the ECJ held that Article 6, second paragraph of the Sixth EC VAT Directive was not applicable to the use of goods and services allocated to the business activities insofar as it related to non-economic activities.

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### **ECJ decides on place of supply of advertisement services in EU/non-EU transactions (*Athesia Druck*)**

On 19 February 2009, the ECJ rendered its judgment in the *Athesia Druck* case (C-1/08), without an Opinion of the Advocate General.

In 1993 and 1994, *Athesia Druck Srl* was a subsidiary of an Austrian company. The Austrian company provided advertising services to German and Austrian clients. In order to provide such services it purchased, amongst others, advertising space from Italian media providers. The Italian VAT charged to the Austrian company was reclaimed by a request under the Thirteenth EC VAT Directive. The request was made by *Athesia Druck* as a tax representative of the Austrian company. In 1999, the

Italian tax authorities imposed a VAT assessment on Athesia Druck, as a tax representative of the Austrian company, as they were of the view that the Austrian company incorrectly did not charge and declare Italian VAT relating to the services to their German and Austrian clients in so far as concerned advertising services in Italy. After several proceedings, the Italian Supreme Court decided to refer questions to the ECJ for a preliminary ruling about the place of supply of advertising services by a non-EU supplier of such services to EU recipients and by EU suppliers of such services to customers established outside the EU.

In a relatively short judgment, the ECJ ruled that, in principle, advertising services to parties established outside the EU are VAT taxable in the country where the customer is established. However, if a Member State exercised the option in Article 9, third paragraph under b of the Sixth EC VAT Directive, the place of taxation is the Member State that exercised the option. The latter only provided that the effective use and enjoyment of the services takes place within the Member State. In such case, it is of no importance whether the non-EU customer is the final customer or an intermediate customer. In the mirror situation, advertising services supplied by a non-EU supplier cannot be liable to VAT under the aforementioned article, not even when the non-EU-supplier acted in the capacity of intermediate customer in respect of an earlier supply of such services. The aforementioned determinations of the place of supply of services are not influenced by the absence or presence of a tax representative. Nor does the place of supply have any influence on the question if a non-EU supplier has a right to refund of input VAT under the Thirteenth EC VAT Directive.

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### **ECJ analyses deductible VAT regarding partially privately used goods (*Sandra Puffer*)**

On 23 April 2009, the ECJ decided in the *Sandra Puffer* case (C-460/07) regarding the limitation of VAT deduction in relation to the private use of goods. Ms Puffer had built a house with swimming pool in Austria and informed the tax authorities that part of it would be used for business purposes. She allocated the entire house to her business assets and, subsequently, claimed deduction of the full input VAT charged to her in connection with the construction of the building. The tax authorities denied deduction with respect to the swimming pool and only allowed for a pro rata deduction of the remainder of the input VAT on the basis of the use of the house for business purposes. Ms. Puffer appealed that decision to the *Verwaltungsgerichtshof* (Austria), which decided to refer four preliminary questions to the ECJ.

In the first question, the Austrian court wanted to know from the ECJ whether the provisions in Article 17, second paragraph under a, point 2 and Article 6, second paragraph under a of the Sixth EC VAT Directive were contrary to the Community principle of equal treatment, because the provisions have the effect of enabling taxable persons to acquire ownership of residential properties for private purposes with a financial advantage contrary to other EU citizens, even if such properties were minimally used for business purposes. In the second question, the court inquired if this financial advantage constituted State aid, which is precluded by Article 87(1) EC.

After the Opinion of Advocate General Sharpston on 11 December 2008, the ECJ decided that the mentioned articles of the Sixth EC VAT Directive do not infringe the Community principle of equal treatment only by conferring on taxable persons a financial advantage, by allowing a full and direct refund of VAT on the construction of a dwelling used both for business and for private purposes, compared to non-taxable persons and to taxable persons who use their property only as a private dwelling. Furthermore, it decided that a national measure which transposes Article 17, second paragraph under a of the Sixth EC VAT Directive and provides that the right to deduct input VAT is only applicable to taxable persons carrying out taxable activities, is not precluded by Article 87(1) EC.

The third and fourth questions of the Austrian court relate to the standstill clause of Article 17, sixth paragraph, second indent of the Sixth EC VAT Directive. As of 1995, this provision has allowed the Austrian legislation to exclude the right to deduct input tax in cases such as that at hand where output tax is, in principle, chargeable on the private use. However, due to an error of interpretation of Community law, the national legislation was altered in 1997 to exempt the private use from output tax entailing the impossibility of deducting input tax. Furthermore, the Austrian legislation contains an overlapping provision on the exclusion of the deduction of input tax, and the referring court asked how such a provision was affected if the

provision it overlapped was considered to fall outside the scope of the standstill clause.

The ECJ decided in this case that the standstill clause must be interpreted as meaning that the derogation it contains does not apply to a provision of national law which amends legislation existing when the Sixth EC VAT Directive entered into force, which is based on an approach which differs from that of the previous legislation and which laid down new procedures. In that respect, the ECJ ruled that was irrelevant whether the national legislation was amended on the basis of correct or incorrect interpretation of Community law. Finally, the ECJ ruled that the question of whether such an amendment of a provision of national law also affects, with regard to the applicability of the second subparagraph of Article 17, sixth paragraph of the Sixth EC VAT Directive, another provision of national legislation, depends on whether those provisions of national law are interdependent or autonomous. This was a matter for the national court to determine.

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### **ECJ rules transferring portfolio of reinsurance contracts is subject to VAT in the Member State of the transferor (*Swiss Re Germany Holding*)**

On 22 October 2009, the ECJ delivered its decision (which had been eagerly awaited by the financial sector) in the *Swiss Re* case (C-242/08), following a reference for a preliminary ruling made by the German Federal Tax Court on 4 June 2008, and the Opinion of Advocate General Mengozzi on 13 May 2009. The question in this case was whether the transfer of a portfolio of life insurance contracts is subject to VAT in the transferor's Member State.

The German based company, Swiss Re Germany Holding GmbH ('Swiss Re'), operates in the reinsurance sector. In 2002, Swiss Re transferred 195 reinsurance contracts to a Swiss-based transferee (S) that belonged to the same group of companies as Swiss Re. The other parties to those contracts with Swiss Re were insurance companies established outside Germany, both in Member States and in third countries. The contracts were transferred in return for payment of a sum by S, which was calculated, inter alia, by ascribing a negative value to 18 of the 195 contracts. For the purposes of determining the final price of the transfer, the value of those 18 contracts was accordingly deducted from the total value of the other 177. The transfer of the reinsurance contracts was completed only upon the consent of the parties which had concluded those contracts with Swiss Re. S took over from Swiss Re the rights and obligations under the contracts which were transferred.

The German tax authorities argued that the transfer of the portfolio was subject to VAT, arguing that the transfer qualified as the transfer of goods and no VAT exemption was applicable. Swiss Re appealed that decision. After several proceedings, the Federal Finance Court decided to refer questions to the ECJ for a preliminary ruling.

In its decision, the ECJ first stated that the transfer of a portfolio of contracts cannot be regarded as a supply of goods given that the contracts are not tangible goods. As a consequence, the ECJ stated that the transfer of the portfolio has to be regarded as a supply of services. Furthermore the ECJ considered that the transfer of a portfolio of insurance contracts cannot be regarded as a banking transaction and, more important, is not a (re)insurance transaction as mentioned in Article 9, second paragraph under e, fifth indent and Article 13 B, under a of the Sixth EC VAT Directive (currently Article 56, first paragraph under e and Article 135, first paragraph under a respectively of the EC VAT Directive). According to the ECJ, the transfer also could not be regarded as a combination of the VAT exempted financial transaction and guarantee transaction as mentioned in Article 13B, under d, under 3 and 2 Sixth EC VAT Directive (currently Article 135, first paragraph under d and c of the EC VAT Directive). The latter because, in the view of the ECJ, applying a VAT exemption is only possible when the services provided form a distinct whole, fulfilling in effect the specific and essential functions of the service that is exempted.

As a consequence, the ECJ ruled that the financial exemptions of Article 13 B Sixth EC VAT Directive (currently Article 135, first paragraph of the EC VAT Directive) do not apply and, moreover, the place of supply of the service has to be determined by the main rule (place of supply of transferor) given that no exception from Article 9, second paragraph Sixth EC VAT Directive (currently article 56 EC VAT Directive) is

applicable. Finally, it is interesting to see that the ECJ also declared that the fact that 18 contracts had been transferred taking a negative value into consideration, does not impact the aforementioned decision.

One of the most important lessons that can be drawn is, contrary to what was the general view in most Member States, that the transfer of a portfolio of (re)insurance contracts can be regarded, at least under certain circumstances, as a 'normal' service for which no VAT exemption applies. The future will reveal to what extent, what kind of contracts and under what conditions, this conclusion can be drawn. In that respect, and certainly because, in principle, the (re)insurance practice does not benefit from a VAT taxed input, the question can also be raised if the transfer of a portfolio of contracts, as in this case, should perhaps be regarded as a transfer of a going concern, which is treated in many of the Member States as being out of the scope of VAT based on Articles 19 and 29 of the current EC VAT Directive. We await in anticipation.

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## **ECJ rules on deduction of VAT on costs relating to the sale of shares in subsidiaries and controlled companies (*AB SKF*)**

On 29 October 2009, the ECJ rendered its long-awaited decision in the *AB SKF* case (C-29/08). *AB SKF* is a Swedish company holding of an industrial group that is active in various countries. The holding company intended to sell one of its subsidiaries and a minor part (26,5%) of the shares it held in another controlled company, which company had been fully owned by *AB SKF* in the past. *AB SKF* supplies services for consideration both to the subsidiary and to the controlled company in the field of management, administration and marketing policy. Those services are subject to VAT. Relating to the sale of the subsidiary and the sale of shares in the controlled company, *AB SKF* wished to purchase various services for which it would be charged with VAT. To have certainty about the VAT issues, *AB SKF* requested the Swedish Revenue Law Commission for a preliminary decision on the right to deduct that input VAT.

The Revenue Law Commission decided that a right to deduct the input VAT related to both sales existed. However, the Swedish Tax Agency appealed the decision and brought the case before the Swedish Court. The Swedish Court decided to refer the following preliminary questions to the ECJ:

1. Are Articles 2 and 4 of the Sixth VAT Directive (currently Articles 2 and 9, EC VAT Directive) to be interpreted as meaning that, where a taxable person liable for VAT on supplies of services to a subsidiary disposes the shares in that subsidiary, that disposal is a transaction subject to VAT?
2. If so, is the disposal covered by the exemption provided for by Article 13 B under d, 5 of the Sixth VAT Directive (currently Article 135, first paragraph under f, EC VAT Directive) in respect of transactions in shares?
3. Regardless of the answers to the first two questions, can there be a right to deduct input VAT on costs directly attributable to the disposal of shares, in the same way as there is a right to deduct input VAT on general costs?
4. Is it of significance for the answers of the first three questions if the disposal of shares in a subsidiary takes place not at once but in stages?

In the light of its case law on the VAT position of holding companies, the ECJ decided to answer the first question such that, where a parent company disposes of all of the shares in a fully owned subsidiary or controlled company that was previously fully owned, and the parent company had supplied VAT taxable services to those subsidiaries, the sale of shares is deemed to be an economic activity for VAT purposes. However, the ECJ also indicated, without being asked in the preliminary questions, that the transfer of shares in such situation might be considered as a transfer of a going concern as mentioned in Article 5, eight paragraph, Sixth VAT Directive and Article 19, EC VAT Directive. Whether or not such is the case, is a question for the national courts to decide in the case the relevant Member State has chosen to exercise the option provided in the aforementioned articles.

Regarding the second question, the ECJ answered, rather briefly, that if the disposal of the shares constitutes an economic activity, the disposal itself is always exempted from VAT pursuant to Article 13 B, under d, 5 of the Sixth VAT Directive and Article 135, first paragraph under f of the EC VAT Directive. As to the third question, the ECJ decided to answer that a right to deduct input VAT on costs for the sale of shares

exists if there is a direct and immediate link between the costs associated with the input services and the overall economic activities of the taxable person. The ECJ then addressed the national courts by deciding that it was up to them to take account of all of the circumstances surrounding the share transactions, such as in this case, and to determine whether the costs incurred are likely to be incorporated in the price of the sold shares or whether they are among only the cost components of transactions within the scope the taxpayers' economic activities. Finally, the ECJ ruled that the foregoing answers to the preliminary questions were not affected by the fact that the disposal of shares is carried out at once or by way of several successive transactions.

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#### 4. Customs Taxes and Excise Duties

##### **ECJ rules on CN classification of multifunctional apparatus (*Kip Europe and Others*)**

On 11 December 2008, the ECJ rendered its decision in the *Kip Europe and Others* cases (C-362/07 and C-363/07). The cases concerned the classification in the Combined Nomenclature ('CN') of apparatus combining the functions of laser printer and a digital scanner module, with a copier function.

Kip Europe SA ('Kip') imported into France apparatus comprising, in a single housing, a large format document laser printer module, a large format digital scanner module ('the scanner module') and a computer running on the Windows operating system, connectable to all kinds of network environments. Each apparatus incorporates all the hardware and software elements needed to perform the various functions, which may be purchased in part or in their entirety by the customer, to whom a code is attributed by reference to the option chosen, an option that can be extended at any time by the attribution of a different code. It is apparent from the observations of Kip that those machines are intended for use by undertakings for drafting plans such as design offices, architects and surveyors. It enables those undertakings, working with specific software, to print plans on the printer linked to their computer over their local network or to digitalise existing plans in order to enter them into computers on their local network and process them. However, the concept of using those machines as stand-alone photocopiers is purely marginal.

Hewlett Packard Int. SARL ('Hewlett Packard') imported into France a number of models of multi-function colour and monochrome printers comprising, in a single housing, a laser printer module and a scanner module having the functional capabilities of printing, digitalisation and copying. Those machines are connectable to computers and receive and process signal code data which are used in the data-processing environment. It is apparent from Hewlett Packard's observations that those multi-functional printers are intended for home use and for small and medium-sized enterprises, and that they are basically intended to be connected either directly or via a network to one or a number of computers.

By six binding tariff opinions ('BTOs') issued on 21 July 2006 at the request of Kip and Others, and on 30 October 2006 at the request of Hewlett Packard, the customs administration *des douanes* took the view that the various machines at issue constituted electrostatic photocopying apparatus operating by reproducing the original image via an intermediate onto the copy, which were to be classified in tariff subheading 9009 12 00. The customs duties on imports applicable to that tariff subheading were 6%.

The importing companies brought proceedings against the administration *des douanes*, seeking the annulment of those BTOs. Principally, they submitted that the machines in question should be classified under tariff subheading 8471 60 of the CN on the basis of General Rule 3(b), since the print module or, at the very least, the print module and the scanner module give them their essential character. In the alternative, they submitted that the digital copy function carried out principally as an input and output unit of an automatic data processing machine would as such fall within subheading 8471 60 and that, under the criterion of the principal use of the apparatus, it was appropriate to decide that the print function is the main function and the subsidiary function is that of an input and output unit of an automatic data processing machine falling as such within subheading 8471 60, which benefits from an exemption from duty. Furthermore, those companies take the view that Regulation No 400/2006 is unlawful in that it bases the classification laid down in

point 4 of the Annex thereto on the premise that the apparatus referred to does not have a particular function which gives it its essential character.

The ECJ ruled that if the copying function performed by the machines at issue in the main proceedings were secondary in relation to the printing and electronic scanning functions, they must be considered units of automatic data-processing machines within the meaning of Note 5(B) to Chapter 84 of the CN constituting Annex I to Regulation No 2658/87, as amended by Regulation No 1719/2005, which units, by application of Note 5(C) to that chapter, if they are presented in isolation, fall within heading 8471. In such a case, the relevant subheading must be determined in accordance with Note 3 to Section XVI of the said nomenclature. However, if the importance of that copying function were equivalent to that of the other two functions, those machines must be classified, by application of General Rule 3(b) of the General rules for the interpretation of that nomenclature, under the heading corresponding to the module which gives those machines their essential character. If such identification proved impossible, they must be classified under heading 9009 in accordance with General Rule 3(c).

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### **ECJ decides on the principle of respect for the rights of the defence (*Sopropé*)**

On 18 December 2008, the ECJ rendered its decision in the *Sopropé* case (C-349/07). This case concerned the question whether there is a situation of infringement of the principle of respect for the rights of the defence in the case a period of eight days has been granted for submission of observations.

Sopropé – Organizações de Calçado Lda ('Sopropé') is a Portuguese undertaking which sells footwear imported from Asia. The dispute in the main proceedings concerns 52 consignments of imported footwear which were declared as originating in Cambodia and which benefited, by virtue of their supposed origin, from preferential customs treatment under the Generalised System of Preferences over a period of two and a half years from 2000 to mid-2002.

An inspection was carried out at the beginning of 2003 by the Portuguese customs authorities' Directorate of Anti-Fraud Services in the context of an administrative cooperation mission launched by the Commission's European Anti-Fraud Office (OLAF) for the purpose of determining the origin of the footwear imported from Asia. The investigations carried out by the customs authorities within Sopropé began on 14 February 2003. Those investigations led the Portuguese authorities to take the view that the abovementioned 52 consignments had been imported on the basis of the submission of falsified certificates of origin and bills of lading. The customs authorities concluded that the imported goods were of non-preferential origin and therefore, could not qualify for the Generalised System of Preferences, and that consequently, the rate of customs duty applicable to goods from non-Member countries had to be applied to them.

On 3 July 2003, Sopropé was informed that it could exercise its right to a prior hearing in respect of the draft findings in the inspection report and the annexes thereto, within a period of eight days, under Article 60 of the Portuguese General Tax Law ('GTL'). The company exercised that right on 11 July 2003. As it took the view that Sopropé had not submitted any new information which could alter the draft inspection report, the customs authorities informed Sopropé, by letter of 16 July 2003, which was received on the following day, that it had a period of 10 days, in accordance with Article 222 of the Customs Code, in which to pay the customs duty owed. Thirteen days had thus elapsed between the date of the notification in respect of the exercise of the right to a hearing and that of the notification relating to payment. Sopropé refused to pay the customs debt of which it had been notified within the prescribed period.

On 8 September 2003, it brought an action before the Administrative and Tax Court of Lisbon, based on, *inter alia*, infringement of the principle of respect for the rights of the defence, by reason of the insufficiency of the period granted to it for submission of its observations. That court, however, held that the decision to recover the duty was justified as no evidence capable of calling it into question had been adduced. Furthermore, it held that the rights of the defence had been respected inasmuch as the requirement relating to a prior hearing, as set out in the GTL, had been satisfied and the procedural rules of the Tax Inspectorate had been complied

with.

Sopropé appealed against that ruling to the Portuguese Supreme Administrative Court on the ground, *inter alia*, that the Court of first instance had not correctly applied the principle of respect for the rights of the defence as guaranteed by Community law. It was in the context of that appeal that the Portuguese Supreme Administrative Court decided to stay the proceedings and to refer the following questions to the ECJ for a preliminary ruling:

1. Is the period of 8 to 15 days set by Article 60(6) of the GTL and by Article 60(2) of the Supplementary Rules of Procedure of the Tax Inspectorate, approved by Decree-Law No 413/98 of 31 December 1998, for the exercise by the taxpayer, either orally or in writing, of the right to a hearing compatible with the principle of respect for the rights of the defence?
2. May a period of 13 days, reckoned from the notification made by the customs authority to a Community importer (in this case, a small Portuguese undertaking dealing in footwear) to exercise its right to a prior hearing within 8 days to the date of notification to pay import duties within 10 days in relation to 52 imports of footwear from the far east under the GSP made over a period of two and a half years (between 2000 and mid-2002), be considered reasonable for an importer to exercise its rights of defence?

With regard to recovery of a customs debt for the purpose of effecting post-clearance recovery of customs import duties, the ECJ ruled that a period of 8 to 15 days allowed to an importer suspected of having committed a customs offence in which to submit its observations complies in principle with the requirements of Community law. According to the ECJ, it is for the national court before which the case has been brought to ascertain, having regard to the specific circumstances of the case, whether the period actually allowed to that importer made it possible for it to be given a proper hearing by the customs authorities. The national court must also ascertain whether, in the light of the period which elapsed between the time when the authorities concerned received the importer's observations and the date on which they took their decision, they can be deemed to have taken due account of the observations sent to them.

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### **ECJ rules on CN classification of monitors (*Kamino*)**

On 19 February 2008, the ECJ rendered its decision in the *Kamino* case (C-376/07). This case concerned the classification in the CN of monitors of the liquid crystal display (LCD) type with SUB-D, DVI-D, USB, S-video and composite video sockets.

In August 2004, Kamino declared, for release into free circulation, a consignment of colour monitors of the LCD type, in which the picture is reproduced with the aid of liquid crystals which reflect light. Those monitors were classified under subheading 8528 21 90. The dimensions of their screens are 53.48 x 46.55 x 24.84 cm (w x h x d) with a 58.42 cm (23 inch) diagonal measurement. The maximum resolution is 1 920 x 1 200 pixel points and the screen aspect ratio is 16:10; horizontal picture frequency is 30 to 81 kHz and vertical picture frequency is 50 to 76 Hz, and they have a brightness of 250 candelas per square metre, 16.7 million colours and a contrast ratio of 500:1. The monitors have D-Sub, DVI-D, USB, S-video and composite-video sockets. As a result the monitor can display pictures from an automatic data-processing machine and pictures from other apparatus. They are also fitted with an audio outlet with a maximum power of 4 watts, to which loudspeakers can be attached.

Taking the view that those monitors should be classified under subheading 8471 60 90, Kamino appealed against the payment notice. That appeal was dismissed by decision of the Customs Inspector on the ground that those monitors are used to reproduce images and can be attached to DVD players, home cinema projectors, games consoles, video cameras, camcorders and automatic data-processing machines. In the appeal lodged before it against that decision, the Court of Appeal of Amsterdam concluded that the characteristics and properties of the colour monitors in question, including the resolution and brightness, meant that they were eminently suitable for use by designers, graphic artists or other such professional users and appropriate in particular for being viewed close up, when placed on a desk or work surface.

That Court found that the monitor was marketed by the manufacturer exclusively in that context and also that the monitor was too expensive to be used solely or principally for games. Accordingly, it held that although use of the monitors by the abovementioned professional users is not exclusive – since they offer other possibilities – from the point of view of sensible and useful use, they are aimed at them in such a predominant manner that as a whole, they satisfy the requirement in Note 5(B) to Chapter 84 of the CN. In the opinion of the Court of Appeal, Regulation No 754/2004 does not preclude that conclusion, because it relates to other apparatus with substantially different technical features. The State Secretary of Finance appealed against that judgment before the Dutch Supreme Court, claiming that, when considering whether Note 5B to Chapter 84 of the CN is satisfied, the Court of Appeal wrongly did not take into account the other possibilities for use of those monitors as part of an automatic data-processing system.

The Dutch Supreme Court asks, on the one hand, where there is no unambiguous criterion from which to determine, by reference to simple technical characteristics, the main purpose of a particular monitor that can reproduce video images from an automatic data-processing machine and also from other sources, whether the target group of users, as defined by reference to the way in which the apparatus is marketed, as well as the sale price of the apparatus, is also of possibly decisive importance. On the other, it asks whether the scope of Regulation No 754/2004 extends to the monitors at issue in the main proceedings.

Against that background, the Dutch Supreme Court decided to stay the proceedings and to refer the following questions to the ECJ for a preliminary ruling:

1. *‘Must Note 5 to Chapter 84 of the CN be interpreted as meaning that a colour monitor which can display both signals from an automatic data-processing machine as referred to in heading 8471 and from other sources is excluded from classification under heading 8471?’*
2. *‘If classification in heading 8471 of the monitor referred to in the first question above is not excluded, on the basis of which criteria must it then be determined whether it is a unit of the sort that is solely or principally used in an automatic data-processing system?’*
3. *‘Does the scope of application of Regulation No 754/2004 extend to the monitor at issue and, if so, in light of the answers to the first and second questions, is that regulation valid?’*

Regarding the first question, the ECJ ruled that classification of monitors such as those at issue in the main proceedings in subheading 8471 60 90, as units of the kind used ‘principally’ in an automatic data-processing system within the meaning of Note 5(B)(a) to Chapter 84 of the CN is not precluded on the sole ground that they are capable of displaying signals coming both from an automatic data-processing machine and from other sources.

Regarding the second question, the ECJ ruled that for the purposes of the tariff classification of these monitors, it is appropriate to refer to the Explanatory Notes relating to heading 8471 of the HS, in particular to points 1 to 5 of Part One, Chapter I(D), relating to display units of automatic data-processing machines. In this note the following is stated:

‘I.– Automatic data-processing machines and units thereof

...

D.– Individual units

...

Included among the constituent units of a data-processing system are display units of automatic data-processing machines which provide a graphical representation of the data processed. They differ from the video monitors and television receivers of heading 8528 in several ways, including the following:

1. Display units of automatic data-processing machines are capable of accepting a signal only from the central processing unit of an automatic data-processing machine and are therefore not able to reproduce a colour image from a composite video signal whose waveform conforms to a broadcast standard (NTSC, SECAM, PAL, D-MAC etc.). They are fitted with connectors characteristic of data-processing systems (e.g. RS-232C interface, DIN or SUB-D connectors) and do not have an audio circuit. They are controlled by special adaptors (e.g. monochrome or graphics adaptors) which are integrated in the central

processing unit of the data-processing machine.

2. These display units are characterised by low magnetic field emissions. Their display pitch starts at 0.41 mm for medium resolution and gets smaller as the resolution increases.
3. In order to accommodate the presentation of small yet well-defined images, display units of this heading utilise smaller dot (pixel) sizes and greater convergence standards than those applicable to video monitors and television receivers of heading 8528. (Convergence is the ability of the electron gun(s) to excite a single spot on the face of the cathode-ray tube without disturbing any of the adjoining spots.)
4. In these display units, the video frequency (bandwidth), which is the measurement determining how many dots can be transmitted per second to form the image, is generally 15 MHz or greater, whereas, in the case of video monitors of heading 8528, the bandwidth is generally no greater than 6 MHz. The horizontal scanning frequency of these display units varies according to the standards for various display modes, generally from 15 kHz to over 155 kHz. Many are capable of multiple horizontal scanning frequencies. The horizontal scanning frequency of the video monitors of heading 8528 is fixed, usually 15.6 or 15.7 kHz, depending on the applicable television standard. Moreover, the display units of automatic data-processing machines do not operate in conformity with national or international broadcast frequency standards for public broadcasting or with frequency standards for closed-circuit television.
5. Display units covered by this heading frequently incorporate tilt and swivel adjusting mechanisms, glare-free surfaces, flicker-free display, and other ergonomic design characteristics to facilitate prolonged periods of viewing at close proximity to the unit.

Regarding the third question, the ECJ considered that, since the monitors at issue in the main proceedings are neither identical nor sufficiently analogous to the goods classified under Regulation No 754/2004, it follows that that Regulation does not apply to those monitors. Therefore, the ECJ ruled that Commission Regulation (EC) No 754/2004 of 21 April 2000 concerning the classification of certain goods in the CN is not applicable for the purposes of tariff classification of the monitors at issue in the main proceedings.

#### *Preliminary comments*

This case concerns the classification of monitors imported in 2004. Upon amendment of the harmonised System in 2007, the explanatory note to which the ECJ refers in its answer to the second question was withdrawn. Nevertheless, ECJ's decision can have an impact on all monitors imported into the EU as of 2004. Bearing in mind the difference in customs duty rates (computer monitors 0%, video monitors 14%), it would be useful to check whether too much customs duty has been paid and, if so, to request for a refund of overpaid customs duty.

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### **ECJ rules on customs value of cars repaired under guarantee (*Mitsui & Co. Deutschland*)**

On 19 March 2009, the ECJ rendered its judgment in the *Mitsui & Co. Deutschland* case (C-256/07). This case concerned the customs value of cars that have been repaired after importation under guarantee.

Mitsui imports new Subaru cars from Japan, which are offered for sale in the EU through distributors. The manufacturer grants a three-year guarantee for those cars to cover technical or other defects. In the context of that guarantee, the manufacturer reimburses to Mitsui the costs which it incurred in relation to third parties under the guarantee, in particular, those pertaining to the implementation of measures by distributors owing to defects in the goods. At the end of each month, Mitsui informs the manufacturer of the services provided under the guarantee to which it has agreed and receives a credit note the following month. Mitsui applied for reimbursement of customs duty for the services provided under the guarantee for the imported cars.

By decision of 27 May 2004, the Principal Customs Office of Düsseldorf granted Mitsui a reimbursement calculated on the services provided under the guarantee and invoiced by Mitsui to the seller/manufacturer until February 2002. On the other hand, the request for reimbursement was rejected in respect of services provided under the guarantee between March 2002 and June 2003. The Principal Customs Office stated

in this connection that, under Article 145(3) of the Implementing Regulation, costs arising under a guarantee could be recognised as reducing the customs value only if the price of the imported goods had been adjusted within 12 months of the goods being released into free circulation. That also applied to customs clearances before the entry into force of Regulation No 444/2002 on 19 March 2002. For goods released for free circulation in July 2000, only price adjustments made prior to or during February 2002 could be taken into account.

Mitsui appealed the decision. It claimed that Article 145 of the Implementing Regulation did not apply to its request for reimbursement, since the cases of guarantees did not involve subsequent price adjustment for the purposes of that provision, but the setting of the amount of a warranty obligation. In addition, that provision, as amended by Regulation No 444/2002, could not be applied to imports which entered into free circulation before 19 March 2002, i.e., prior to the entry into force of Regulation No 444/2002. Community law includes a general prohibition on the retroactive application of Community acts, which encompasses substantive provisions such as Article 145(2) and (3) of the Implementing Regulation.

As the German Tax Court of Düsseldorf was uncertain as to the interpretation of Article 29 of the Customs Code and the interpretation and validity of Article 145(2) and (3) of the Implementing Regulation, it decided to stay proceedings and to refer the following questions to the Court for a preliminary ruling:

- '(1) Do payments by the seller/manufacturer to the buyer which, as in the present case, are made in the context of a guarantee agreement and by which the buyer is reimbursed the expenditure on repairs invoiced to him by his reduce the customs value under Article 29(1) and (3)(a) of the Customs Code which was declared on the basis of the price agreed between the seller/manufacturer and the buyer?
- (2) Do the payments referred to in Question 1 by the seller/manufacturer to the buyer for the reimbursement of expenses incurred under a guarantee constitute an adjustment of the transaction value under Article 145(2) of the Implementing Regulation?
- (3) Should either of the first two questions be answered in the affirmative: is Article 145(2) and (3) of the Implementing Regulation to be applied to imports in respect of which the customs declarations were accepted before the entry into force of Regulation No 444/2002?
- (4) Should Question 3 be answered in the affirmative: is Article 145(2) and (3) of the Implementing Regulation valid?'

The ECJ ruled that the relevant legislation must be interpreted as meaning that, when defects affecting goods became apparent after the goods were released for free circulation, but it is demonstrated that they existed before such release, and those defects give rise, under a warranty obligation, to subsequent reimbursements by the seller/manufacturer to the buyer, reimbursements which correspond to the costs of repairs invoiced by the buyer's own distributors, such reimbursements can result in a reduction of the transaction value of the goods and, as a result, of their customs value, which was declared on the basis of the price initially agreed between the seller/manufacturer and the buyer. Furthermore, the ECJ ruled that Article 145(2) and (3) of Regulation No 2454/93 does not apply to imports in respect of which the customs declarations were accepted before 19 March 2002.

It can be derived from this judgment that if the legal conditions are met, refund of import duty calculated on the amounts mentioned on the credit notes can be achieved.

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### **ECJ rules upon tariff classification of fermented beverage containing distilled alcohol (*Siebrand*)**

On 7 May 2009, the ECJ rendered its judgment in the *Siebrand* case (C-150/08). The case concerned the classification in the CN of fermented beverage containing distilled alcohol.

*Siebrand* is a company which produces alcoholic and non-alcoholic beverages. It produces, *inter alia*, three alcoholic beverages called 'Pina Colada', 'Whiskey Cream' and 'Apfel Cocktail' respectively. These are produced from a cider base to which distilled alcohol, water, sugar syrup, various aromas and colourings are added, and, in the case of Pina Colada and Whiskey Cream in particular, a cream base. The three beverages have an alcoholic strength by volume of 14.5%, of which 12% is

attributable to the distilled alcohol and 2.5% to the alcohol obtained by the fermentation of apple concentrate.

Until 1 January 2003, the products in question were classified by the inspector of taxes ('the Inspector') under heading 2206 of the CN, which also determined the rate of excise duty applicable to them. However, in accordance with the decision of the State Secretary of Finance of 15 January 2003, the Inspector adopted the stance that, in view of the alcoholic strength by volume and the nature of the products in question, these beverages should be classified with effect from 1 January 2003 under heading 2208 of the CN. This resulted in a higher rate of excise duty.

Although the Inspector deferred the application of the new rate until 1 July 2003, he issued Siebrand with eight notices of additional assessment for the period between July 2003 and February 2004. Siebrand lodged objection to those notices of assessment, but the Inspector maintained his stance in his decision on the objection. Siebrand then brought an action before the Regional Court of Appeal of Arnhem, which held that the products in question should be classified under heading 2208 of the CN.

Hearing the case on Siebrand's appeal against that judgment, the Dutch Supreme Court decided to stay the proceedings and to refer the following questions to the ECJ for a preliminary ruling:

1. 'Can a beverage which contains a certain amount of distilled alcohol but which otherwise corresponds to the definition of heading 2206 of the [CN] be classified under that heading if the beverage in question is a fermented beverage which, as a result of the addition of water and particular ingredients, has lost the taste, smell and/or appearance of a beverage produced from a particular fruit or natural product?'
2. In the event of a positive answer to Question 1, what criterion should govern the determination as to whether the beverage is nevertheless to be classified under heading 2208 of the CN on the ground that it contains distilled alcohol?'

The ECJ stated that under general rule 3(b), in carrying out the classification of goods, it is necessary to identify from among the materials of which they are composed, the one which gives them their essential character. Consequently, it is necessary to identify, from among the materials of which products such as those at issue in the main proceedings are composed, the one which gives them their essential character. It is apparent from the order for reference that these products are made from cider, to which are added distilled alcohol, water, sugar in the form of syrup, various aromas and colourings and, in the case of Pina Colada and Whiskey Cream, a cream base. The end products have an alcoholic strength by volume of 14.5%, 2.5% from alcohol fermented from cider and 12% from added distillate.

The products at issue have, as a result of the addition of water and other substances, lost the taste, smell and appearance of a beverage produced from a particular fruit or natural product, that is to say a fermented beverage. The particular organoleptic characteristics of those products, which define their essential character, therefore correspond to those of products classified in heading 2208 of the CN.

Finally, the ECJ stated that it is important to note that the intended use of a product may constitute an objective criterion for classification if it is inherent to the product, and that inherent character must be capable of being assessed on the basis of the product's objective characteristics and properties. It is common ground that the objective characteristics and properties of products such as those at issue in the main proceedings, including the form, colour and name under which they are marketed, correspond to those of a spirituous beverage.

Therefore the ECJ ruled that fermented alcohol-based beverages corresponding originally to heading 2206 of the CN in Annex I to Council Regulation (EEC) No 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff, as amended by Commission Regulation (EEC) No 2587/91 of 26 July 1991, to which a certain proportion of distilled alcohol, water, sugar syrup, aromas, colourings and, in some cases, a cream base have been added, resulting in the loss of the taste, smell and/or appearance of a beverage produced from a particular fruit or natural product, do not come under heading 2206 of the CN but rather under heading 2208 thereof. As a result of the classification under CN heading 2208, the products at issue attract a considerably higher tariff of excise in the Netherlands than products that are classified under heading 2206.

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## **ECJ rules upon duty exemption for goods with negligible value (*Har Vaessen*)**

On 2 July 2009, the ECJ rendered its decision in the *Har Vaessen* case (C-7/08). This case concerned the duty exemption for goods with a negligible individual value, dispatched as a grouped consignment.

Har Vaessen is a transportation company which, in the period from 12 November 1998 to 28 October 1999, made declarations for release for free circulation in respect of compact discs and magnetic tapes on behalf of ECS Media BV ('ECS'), an undertaking established in the Netherlands. Those goods, with an individual value of less than EUR 22, had been ordered by individual customers from ECI voor Boeken en Platen BV ('ECI'), the parent company of ECS, also established in the Netherlands. Under an agreement between ECS and ECI, ECI transferred the orders to ECS which then prepared the goods for dispatch from a distribution centre in Switzerland. Under cover of a T1 document, they were transported to the Netherlands. The goods were then cleared by customs agent Har Vaessen. After clearance, the goods were transported to a distribution centre in the Netherlands, from where they were delivered individually to ECI's customers by PTT Post BV ('PTT'), a Dutch undertaking. Each individual parcel included the name of the customer receiving the goods and a remittance form for payment thereof.

In the declaration for release for free circulation of the goods at issue in the main proceedings, Har Vaessen claimed relief under Article 27 of Regulation No 918/83 as amended, which was refused. By notice of assessment of 29 December 1999, it was therefore requested, in particular, to pay customs duties in the sum of NLG 436,907.60, i.e. approximately EUR 198,260.02. Objections against the duty assessment were turned down and appeal initiated. The Dutch Supreme Court decided to stay the proceedings and to refer the following questions to the ECJ for a preliminary ruling:

1. Is Article 27 of Council Regulation (EEC) No 918/83 as amended to be interpreted as meaning that the relief referred to in that article may be claimed in respect of consignments made up of goods which are individually of negligible value but are dispatched as a grouped consignment with a combined intrinsic value which exceeds the value threshold in Article 27?
2. Should Article 27 of Council Regulation (EEC) No 918/83 as amended be applied on the basis that 'dispatched direct from a third country to a consignee in the Community' also covers a situation in which the goods are in a third country before being dispatched to the consignee but the consignee's contractual partner is established in the Community?

The ECJ ruled that Article 27 of Council Regulation (EEC) No 918/83 does not preclude grouped consignments of goods, with a combined intrinsic value which exceeds the value threshold laid down in Article 27, but which are individually of negligible value, from being admitted free of import duties, provided that each parcel of the grouped consignment is addressed individually to a consignee within the Community. In that respect, the fact that the contractual partner of those consignees is itself established in the Community is not relevant where the goods are dispatched directly from a third country to those consignees. From the judgment, it can further be derived that the duty exemption only applies in the case the goods, prior to their entry for free circulation, were placed under another customs procedure.

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## **ECJ rules upon amount of duty to be communicated to the debtor (*a.o. Snauwaert*)**

On 16 July 2009, the ECJ rendered its decision in the *Snauwaert* case (joined cases C-124/08 and C-125/08). These cases concern the communication of a customs debt to the person liable for payment. The actions in the main proceedings, as described by the referring court, concern a number of frauds relating to the import of meat not permitted on the European market, which occurred in Belgium in the mid-1990s.

The purpose of those frauds was both to bring on to the European market cheap meat from third countries which was normally unfit for human consumption according to the national and Community standards and to claim export refunds unlawfully. As a

result of the frauds, import duties in relation to the goods in question were evaded, since the competent customs authorities did not possess the information required in order to enter them in the accounts.

It is apparent from the order for reference in Case C-124/08 that, at the end of the proceedings, which took place before the Criminal Court of Antwerp at first instance, and the Court of Appeal of Antwerp on appeal, Mr Snauwaert, Mr Vlaeminck, Mr Den Haerynck and Mrs De Wintere were jointly and severally ordered to pay the evaded import duties and levies, together with default interest. Algemeen Expeditiebedrijf Zeebrugge BVBA and Coldstar NV were declared liable, as a matter of civil law, for the sums due from Mr Snauwaert and Mr Den Haerynck respectively.

The referring court stated that, in support of their appeal in cassation against the judgment of the Court of Appeal of Antwerp of 25 October 2006, the appellants in the main proceedings relied, in particular, on the provisions of Article 221(1) and (3) of the customs code, arguing that that court erred: first, in finding that the failure to enter in the accounts the amount of import or export duty legally due, or the late entry thereof, does not affect the right of the customs authorities to proceed to recovery of that duty; and, second, in finding that, for the purposes of extending the three year limitation period from the date on which the customs debt was incurred, laid down in Article 221(3), it is not necessary to ascertain who ultimately committed the act liable to give rise to criminal court proceedings as a result of which the authorities were unable to determine the amount in question.

In those circumstances, the Court of Cassation decided to stay the proceedings and to refer the following questions to the ECJ for a preliminary ruling:

1. Should Article 221(1) of the customs code be construed as meaning that the communication of a customs debt to the person liable for payment can be lawfully effected only after it has been entered in the accounts or, in other words, that the communication of a customs debt to the person liable for payment should always be preceded by its entry in the accounts if it is to be lawful and to comply with that provision?
2. Should Article 221(3) of the customs code be construed as meaning that the option of lawfully communicating the amount entered in the accounts after the period of three years from the date on which the customs debt was incurred, if that debt is the result of an act which is liable to give rise to criminal court proceedings, is available to the customs authorities only in respect of the person who is responsible for that act?

It is apparent from the order for reference in Case C-125/08 that, by the judgment of the Court of Appeal of Antwerp of 2 May 2007, Mr Deschaumes was ordered to pay the evaded import duties and levies, together with default interest.

The referring court stated that, in support of his appeal in cassation against that judgment, Mr Deschaumes relied, in particular, on the provisions of Article 221(1) of the customs code, arguing that the Court of Appeal of Antwerp did not find that the customs debt had been entered in the accounts before it was communicated, and that it was not evident from the file in the main proceedings that such entry in the accounts was made.

In those circumstances, the Court of Cassation decided to stay the proceedings and to refer to the ECJ for a preliminary ruling a question identical to the first question referred in Case C-124/08. By order of the President of the Court of 22 April 2008, Cases C 124/08 and C 125/08 were joined for the purposes of the written and oral procedure and of the judgment.

The ECJ ruled as follows:

1. Article 221(1) of Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code must be interpreted as meaning that the amount of import or export duty due may be validly communicated to the debtor by the customs authorities in accordance with appropriate procedures, only if the amount of that duty has been entered in the accounts beforehand by those authorities.
2. Article 221(3) of Council Regulation (EEC) No 2913/92 must be interpreted as meaning that the customs authorities may, after the expiry of the period of three years from the date on which the customs debt was incurred, validly

communicate to the debtor the amount of duty legally due, where the exact amount of that duty could not be determined by those authorities as a result of an act that could give rise to criminal court proceedings. That includes cases where the debtor has not committed that act.

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## 5. Capital Duty

### **ECJ holds aspects of Spanish capital duty incompatible with EC law (*Commission v Spain*)**

On 9 July 2009, the ECJ rendered its judgment in the *Commission v Spain* case (C-397/07). On 10 July 2006, the Commission decided to refer Spain to the ECJ for a number of infringements of Directive 69/335/EEC concerning indirect taxes on the raising of capital, as amended by Council Directive 85/303/EEC (the 'Capital Duty Directive'). Spain did not amend its legislation despite a formal request by the Commission dated 13 July 2005.

According to the Commission, Spain infringed the Capital Duty Directive by only exempting certain reorganisation transactions, which are identified in Article 7(1)(b) and (bb) of the earlier version of the Capital Duty Directive (the latter provision applying to the exchange of shares where a company receives a least 75% of the issued share capital of another company), if the taxpayer opted for such exemption, whereas the Capital Duty Directive provided for a mandatory exemption from those transactions. Moreover, the Commission considered that Spain infringed the Capital Duty Directive when levying capital duty (i) on the transfer of the registered office or the effective centre of management of a company from another Member State to Spain, if the creation of the relevant company had not been subject to capital duty in the other Member State (which under the Capital Duty Directive has an option not to apply a capital duty), and (ii) on capital used for trading operations carried out by Spanish branches and permanent establishments of companies created in other Member States which do not levy capital duty, since the Capital Duty Directive did not provide for the possibility to levy capital tax in such cases.

The ECJ agrees with the Commission and found that:

- by making the exemption from capital duty for the transactions referred to in Article 7(1)(b) of the Capital Duty Directive subject to certain conditions,
- by subjecting to capital duty the transfer, from a Member State to Spain, of the effective centre of management or the registered office of capital companies which have not been subject to a similar tax in their country of origin, and
- by subjecting to capital duty capital allocated to commercial activities pursued in Spain by branches or permanent establishments of companies established in a Member State which does not apply a similar tax,

the Kingdom of Spain has failed to fulfil its obligations under the Capital Duty Directive.

The only complaint of the Commission that was not upheld concerned the exemption on transactions falling within Article 7(1)(bb) of the Capital Duty Directive being subject to a formal option.

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### **ECJ holds UK tax charged on transfer of shares into a clearance service incompatible with EC law (*HSBC Holdings and Vidacos Nominees*)**

On 1 October 2009, the ECJ rendered its judgement in the case of *HSBC Holdings and Vidacos Nominees* case (C-569/07) concerning the compatibility of UK stamp duty reserve tax ('SDRT') with Articles 10 and 11 of Council Directive 69/335/EEC of 17 July 1969 concerning indirect taxes on the raising of capital, as amended by the Capital Duty Directive, as well as Articles 43, 49 and 56 EC.

Under the applicable UK legislation, no SDRT is charged on the issue of the shares in

certificated form but all transfers of shares or other chargeable securities for consideration are subject to SDRT at a rate of 0.5% of the amount or value of the consideration for the transfer. Conversely, SDRT is due on the issue or transfer of non-certified shares to the operator of a clearance service at a rate of 1.5% of the issue price or the amount or value of the consideration, whereas subsequent transfers of shares within the same clearance service are not taxed. Furthermore, a clearance service may elect to enter into an agreement with the Inland Revenue based on which, payment of SDRT is made at the standard rate of 0.5% (on each transfer), provided a number of requirements are met.

On 7 June 2000, HSBC Holdings plc ('HSBC'), a company incorporated and resident for tax purposes in the UK, made a public offer to acquire all of the issued shares of Cr dit commercial de France ('CCF'), a public company incorporated and resident for tax purposes in France, the shares of which were listed on the Paris Stock Exchange. As consideration for the acquisition of CCF shares, HSBC issued shares listed on the Paris Stock Exchange to a clearance service, namely, Vidacos Nominees Ltd, and SDRT was therefore charged at the rate of 1.5% of the price or value of those shares.

According to the ECJ, the 1.5% SDRT on the first transfer of newly issued shares was unacceptable under Article 11 of the Capital Duty Directive, which provides that no tax may be charged on, amongst others, the creation, issue, admission to quotation on a stock exchange, and making available on the market or dealing in stocks. Moreover, in the ECJ's view, the exception provided for in Article 12(1) of the Capital Duty Directive, according to which duties on the transfer of securities are acceptable, does not apply since this exception should be interpreted narrowly. Therefore, the ECJ concluded that Article 11(a) of the Capital Duty Directive must be interpreted as meaning that it prohibits the levying of a duty, such as that at issue in the main proceedings, on the issue of shares into a clearance service.

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### **ECJ holds Polish taxation of conversion of loans into share capital incompatible with EC law (*Elektrownia Patn w*)**

On 12 November 2009, the ECJ rendered its judgement in the *Elektrownia Patn w* case (C-441/08). The case concerns the interpretation of the second indent of Article 5(3) of the Capital Duty Directive, which provides that the amount of capital duty that is charged in the case of an increase in capital shall not include the amount of the loans taken up by a capital company which are converted into shares in the company and which have already been subjected to capital duty.

Prior to Poland's accession to the EU, Polish domestic law provided for taxation of civil law transactions in respect of, *inter alia*, loans taken up from shareholders. In this case, the Polish company *Elektrownia Patn w* had taken up a series of loans from its (Polish resident) parent company between 2002 and 2004. In accordance with the domestic law at that time, *Elektrownia Patn w* had paid the tax on civil law transactions on the loans it had taken up. With effect from 1 May 2004, Poland became a Member State. In 2005, the loans taken up by *Elektrownia Patn w* were converted into share capital. This transaction was subject to the tax on civil law transactions, which had been amended in order to comply with the Capital Duty Directive, without taking account of the earlier taxation of the loans. *Elektrownia Patn w* filed a complaint with the tax authorities on the basis that it had incurred double taxation. In the ensuing legal proceedings, the Polish administrative court referred to the ECJ the question whether the second indent of Article 5(3) of the Capital Duty Directive (cited above) also applies in a situation in which the conversion into shares took place after the accession of a Member State to the EU, even though the loans predated that accession and had been taxed in accordance with the national law which was in force at that time.

The ECJ considered that the second indent of Article 5(3) of the Capital Duty Directive should be regarded as a new rule which applies immediately to transactions which are carried out after its entry into force in Poland and which come within its scope. Therefore, in determining the amount of capital duty due on the conversion into shares of loans taken up prior to Poland's accession to the EU and converted after Poland's accession, the previous taxation of those loans on the basis of the national law in force at that earlier time should be taken into account (thus reducing the double taxation in this case).

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