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1. Top News

EU Council publishes revised Code of Conduct for the effective implementation of the EU Arbitration Convention on transfer pricing disputes

On 30 December 2009, the EU Council published in the EU Official Journal 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'). The revised Code of Conduct follows the Commission's Communication COM(2009) 472 final of 14 September 2009 (see EU Tax Alert, edition no. 73, December 2009) and addresses some of the operational problems that the EU Joint Transfer Pricing Forum ('JTPF') identified in the original Code of Conduct, as follows.

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- 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.

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Several Member States – Bulgaria, the Czech Republic, the Netherlands, Greece, Hungary, Italy, Latvia, Poland, Portugal and Slovakia – made reservations on the latter point, considering to fall outside the scope of the EU Arbitration Convention adjustments to the amount of the loan and/or the deductibility of the interest based on a thin capitalization approach under the arm's length principle, and/or adjustments based on (domestic) anti-abuse legislation based on the arm's length principle. Some Member States agreed to review their reservations once the OECD gives guidance on how to apply the arm's length principle to thin capitalization of associated enterprises.

Admissibility of a case

On the basis of Article 18 of the EU Arbitration Convention, 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.

Serious penalties

With regard to serious penalties covered by Article 8(1) EU Arbitration Convention, whereby access to the EU Arbitration Convention may be denied, Member States are recommended to clarify or revise their unilateral declarations in the Annex to the EU Arbitration Convention in order to better reflect that a serious penalty should only be applied in exceptional cases like fraud.

Starting point of the three-year period deadline for submitting a request

The three-year period starts from the date of the first tax assessment notice or equivalent which results or is likely to result in double taxation. As far as transfer pricing cases are concerned, Member States are recommended to adopt this definition also to determine the three-year period provided under double tax treaty provisions based on Article 25(1) of the OECD Model Tax Convention.

Starting point of the two-year period deadline for submitting a case

The two-year period starts from (i) the date of the tax assessment notice, i.e. a final decision of the tax administration on the additional income, or equivalent; or (ii) the date on which the competent authority receives the request and the minimum information, as defined in the revised Code of Conduct.

Mutual agreement procedures under the EU Arbitration Convention

A mutual agreement should be reached as promptly as possible, by any appropriate means (e.g. including face-to-face meetings), within two years of the date on which the case was first submitted to one of the competent authorities, and in complex situations, it may be appropriate to agree to a short extension. The mutual agreement procedure should not impose any inappropriate or excessive compliance costs on the person requesting it, or on any other person involved in the case. The revised Code of Conduct has established special provisions concerning EU triangular cases, depending on whether the competent authorities decide to start one bilateral procedure, more than one bilateral procedure in parallel, or a multilateral procedure. The revised Code of Conduct also set some rules on the practical functioning of the mutual agreement procedure and its transparency, as well as on procedures and deadlines concerning the exchange of position papers.

Proceedings during the second phase of the EU Arbitration Convention

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

Tax collection and interest charges during cross-border dispute resolution procedures

When a case is being 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).

Accession of new Member States to the EU Arbitration Convention

Member States will endeavour to sign and ratify the conventions on accession of new Member States to the EU Arbitration Convention as soon as possible and in all events, no later than two years after their accession to the EU.

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Developments in Germany: Ministry of Finance issues guidance on application of ECJ judgment in *Deutsche Shell*

On 23 November 2009, the German Ministry of Finance issued official guidance on the application of the ECJ judgment in *Deutsche Shell* (C-293/06). In this judgment, the ECJ ruled that a currency loss must be considered deductible in the home State of a company upon the repatriation of start-up capital granted to its permanent establishment in another Member State.

It is noted in this guidance that the ECJ judgment only relates to a specific legal issue regarding the termination of a Permanent Establishment ('PE') situated in an EU/EEA Member State. It is the obligation of the taxpayer to prove that in a specific case a currency loss occurred. If such evidence is provided, a currency loss resulting from the repatriation of the start-up capital of a PE situated in another Member State must be taken into account for determining the taxable base of the domestic company at the time of the effective termination of the foreign PE.

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EU initials deal on bananas with Latin American countries

On 15 December 2009, ambassadors from the EU and Latin American countries agreed to end a 15-year dispute over EU banana imports. In the deal, seen as a boost for the Doha Round of world trade talks, the EU will gradually cut its import tariff on bananas from Latin America from EUR 176 per tonne to EUR 114. In response, the US has agreed to settle its related dispute with the EU. The EU has also offered to mobilise up to EUR 200 million for the main African and Caribbean banana-exporting countries to help them adjust to stiffer competition from Latin America.

Continued EU support for African and Caribbean producers

Bananas from African, Caribbean and Pacific countries ('ACP') will continue to enjoy duty free and quota free access to the EU under separate trade and development agreements. The deal offers these countries two important outcomes:

'Tropical' and 'Preference Erosion' products

In parallel, the EU, ACP and Latin American countries have agreed on an approach to the so-called 'tropical' and 'preference erosion' products, which they will jointly promote in the context of the on-going DDA negotiations. 'Tropical products' will be subject to deeper tariff cuts, and tariff cuts for 'preference erosion' products of interest to ACP countries will be conducted over a relatively longer period.

Dispute with the US also settled

In parallel, the EU and the US have initialled a deal in which the US agrees to settle its WTO dispute on bananas with the EU.

A new process for approving the agreement

Once the EU Council approves the banana agreement, it will sign the deal with Latin American countries. It will also sign a settlement agreement with the US. Then, to comply with the recently ratified Lisbon Treaty, the European Parliament must give its consent before the Council can conclude the deals.

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2. State Aid/WTO

Recovery of special tax benefits from France Télécom upheld by CFI

On 30 November 2009, the Court of First Instance (the 'CFI') upheld a 2004 Commission decision to order recovery of tax benefits from France Télécom. From 1994 to 2002, France Télécom was subject to the normal tax system, with the exception of certain direct (business) taxes in respect of which special arrangements applied. From 1991-1993, France Télécom was exempt from tax although it had to pay a lump sum to the French State, covering both taxes and participation risks of the State, which is the main shareholder. While the Commission was satisfied that the 1991-1993 lump sum payment was higher than the amount of tax that would have been due, resulting in no benefit being present in the Commission's and France's view, it did not allow the excess lump-sum payment to be taken into account as to result in a lower amount to be recovered in respect of the 1994-2002 regime. The latter regime was deemed to be State aid, because France Télécom paid less tax than under the normal regime. The exact amount will have to be determined by the French State, although based on some previous estimates by France, the Commission has indicated it to be between EUR 798 million and EUR 1,140 million plus interest. In the absence of notification, France could not rely on the protection of legitimate expectations in order to avoid recovery, according to the CFI. The ECJ had ruled as early as 2007 that France had failed to comply with this obligation.

On a procedural note, the CFI established that the Commissioner of competition had not overstepped his competences when changing the content of the decision as part of the legal language revision after the adoption of that decision by the collective body of the Commissioners, as it did not affect the factual and legal elements of the decision as established by the collective. One of the main issues was whether the EUR 798 million is to be regarded as an absolute minimum or as a mere indication of the final outcome since the word 'indicative' had been removed from the decision, according to parties.

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General court annuls decision in respect of tax benefits given by France to EDF

On 15 December 2009, the General Court (the new name for the Court of First Instance as of 1 December 2009) ruled that a 2003 Decision concerning a tax concession for Electricité de France ('EDF') made by France had to be annulled. In 2002, France allowed EDF not to pay about EUR 889 Million in taxes resulting from 1997, when tax provisions for the renewal of its network were added to capital, because of them not being used as a result of the opening up of the European internal electricity market. EDF has since repaid the said amount including interest (to a total of EUR 1.2 Billion).

Amongst the issues addressed on appeal, the most relevant from a tax perspective was EDF's claim that France's action had to be regarded as an additional capital injection in an amount equivalent to the amount of the tax due. If it were so regarded, the Commission should have assessed the capital injection as such and not have focussed on the mere nature of the benefit (cancellation of tax debt), i.e., the amount of tax due could have been considered paid by setting it off against the capital injection due.

The State as shareholder could have been acting as a private investor, a circumstance not properly assessed by the Commission. The mere fact that the capital had been derived in part from a tax debt did not preclude the injection itself from being assessed in light of whether the State acted as a private investor (pursuing returns on investment in line with the market in which case aid would not be involved). The General Court thus referred the case back to the Commission to conduct such an assessment and to take a new decision (without prejudice to the outcome of the private investor test).

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Commission prohibits Dutch energy tax exemption for production of ceramic products

After an in-depth investigation opened in February 2009, the Commission found that a tax exemption the Netherlands intended to grant for natural gas used in installations for the production of ceramic products would be in breach of State aid rules and therefore, could not be implemented. In particular, the Commission found that the tax exemption would provide a selective advantage to the Dutch ceramic sector and thus constitute operating aid. Such aid can be authorised only if it furthers, at least indirectly, environmental objectives, in line with the requirements of the EU Guidelines on State Aid for Environmental Protection. As the Netherlands has not demonstrated how the measure would comply with the relevant provisions of these Guidelines, the Commission has concluded that the measure would be incompatible with the State aid rules.

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Commission bans tax benefits for Spanish agricultural cooperatives

On 15 December 2009, the Commission declared tax incentives related to the supply of gasoil by Spanish agricultural cooperations to non-Members to be incompatible State aid. This was the second time the Commission has taken a decision in the matter, after annulment of its 2003 decision. While Spanish agricultural cooperations were entitled to special tax treatment, Spain proposed in 2000 to allow this treatment to apply even in cases where more than half of their turnover would have resulted from supplying gasoil to non-members. It also proposed to abandon the requirement to constitute a new legal entity subject to the general tax system for such non-member distribution.

The Commission pointed out that while cooperations may facilitate the development of agricultural activity, allowing the supply of gasoil to non-members to be covered by their special tax treatment would constitute a benefit vis-à-vis companies with share capital operating under the same circumstances. The Commission, therefore, ordered recovery of tax advantages received in respect of the supply to non-members in excess of the previous 50% limit, in those circumstances where no separate legal entity had been established. Aid below the de *minimis* level may be excluded therefrom.

Please note that the previous tax treatment of Spanish agricultural cooperatives as it was prior to 2000 was allowed to stand, since it was not the subject of this investigation. This might explain why the Commission was willing to accept the extra-cooperative supply up to 50%, albeit that – given the Commission's reasoning – this kind of aid may be reviewed in future as part of the permanent monitoring procedures.

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3. Direct Taxation

EU Committee publishes Opinion on proposed Mutual Assistance and Administrative Cooperation Directives

On 22 December 2009, the European Economic and Social Committee published its Opinion 2009/C 317/23 adopted on 16 July on the proposed Council Directives concerning mutual assistance for the recovery of taxes (COM(2009) 28 final -- 2009/0007 (CNS)) and administrative cooperation in the field of taxation (COM(2009) 29 final -- 2009/0004 (CNS)).

Background

The 30-year old legislation that is to be replaced by the proposed Council Directives has proved inadequate in the light of current requirements. The fact that only 5% of claims are currently recovered calls for an urgent response. Globalisation makes the need for States to cooperate in the field of taxation even more pressing. In the EU, the fundamental freedoms that underpin its workings cannot be used to cover up failure to comply with the public obligation to pay taxes. The need for reform is escalating, as companies are having to deal with the social and economic fallout of the economic meltdown caused by the speculative and fraudulent practices uncovered in late 2007. This fallout, which will place a considerable burden on taxpayers for years to come, has led to the urgent call for effective measures to be adopted against the fraudsters who operate from the safety of tax havens or who use legal loopholes to avoid paying tax.

Consequently, it is proposed to adopt an innovative approach that goes beyond simply making changes to the current directives. The new scheme, therefore, represents a new and integrated legal framework that covers all the fundamental aspects of administrative cooperation in the field of taxation, markedly boosting the authorities' powers to combat fraud and tax evasion. Since the aim is to establish effective mechanisms for cooperation between the Community authorities and the Member States and between the Member States themselves, a key objective of the two proposals is to set common rules, whilst fully respecting national sovereignty in the field of taxation.

Proposal for a Council Directive concerning mutual assistance for the recovery of taxes

Tax authorities lack the power to recover taxes beyond their State borders because legislation in this field is national in nature: in order to recover taxes, the authorities must request the assistance of another Member State (or States), using procedures that have proven to be ineffective. The current legislation on mutual assistance (Directive 76/308/EEC of 15 May 1976, subsequently codified by Council Directive 2008/55/EC of 26 May 2008) is slow, disparate and lacks coordination and transparency. There is, therefore, a clear need for newly proposed measures, as follows.

- extension of the scope of mutual assistance, covering 'all taxes and duties levied by or on behalf of Member States' territorial or administrative subdivisions, including the local authorities', as well as compulsory social security contributions, 'refunds, interventions and

- other measures';
- better exchange of information, including the option of officials from one Member State being able to participate actively in enquiries carried out by another Member State, in addition to the existing spontaneous exchange of information;
- simplification of the procedure for the notification of documents;
- several provisions concerning more effective recovery and precautionary measures;
- uniformity and simplification of the general rules governing requests in relation to forms, means of communication, use of languages, etc.

Proposal for a Council Directive on administrative cooperation in the field of taxation

According to the Commission, the serious shortcomings of 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'), have created increasing difficulty in assessing taxes correctly, affect the functioning of taxation systems and entail double taxation, which itself incites tax fraud and tax evasion, while the powers of control remain at national level. There is, therefore, a clear need for newly proposed measures, as follows.

- extension of the scope of legislation along the lines of the preceding proposal on the recovery of claims;
- three proposals for exchanging information are put forward: (i) a prior request by the requesting authority which might entail carrying out 'any administrative enquiries' necessary to obtain the information; (ii) automatic exchange of information, i.e. systematic communication of predefined information from one Member State to another, without prior request, at pre-established regular intervals or as and when that information becomes available; and (iii) spontaneous exchange, where the competent authorities of a Member State deem this appropriate;
- other forms of cooperation: (i) the presence of officials from the requesting authorities in the offices of the administrative authorities and their participation in the administrative enquiries of the requested authority; (ii) simultaneous controls of one or more persons in different States; and (iii) rules governing the administrative notification decided on in another Member State;
- general aspects of administrative cooperation: (i) speedy feedback; (ii) sharing of best practices and experience; (iii) different aspects of cooperation by requesting or requested authorities
- other aspects covered are: (i) conditions governing Member States' obligations; (ii) limits on the obligation to cooperate; (iii) application of the principle of 'most favoured nation'; (iv) standard forms and computerised formats; and (v) use of the common communication network.

Conclusions and recommendations

The European Economic and Social Committee welcomed the proposals for directives on mutual assistance for the recovery of claims relating to taxes and administrative cooperation in the field of taxation, because they meet an urgent need. The Commission's proposals take account of studies, suggestions and recommendations that have been made by the EU, in the Member States and in international fora and institutions such as the G-20 and the OECD. The European Economic and Social Committee too has, in a number of opinions, given its unreserved support to the proposals aimed at making arrangements for cooperation between States in the field of taxation more effective.

The European Economic and Social Committee endorsed the core aim of the proposals, which is to establish a Community administrative culture and give administrations the appropriate tools provided by modern technology (such as electronically-processed forms and provisions on language arrangements, one of the main obstacles to cooperation in the field of taxation) to make procedures simpler and swifter. The obligation to provide information and the limits set in the Commission's proposals are in line with the OECD's procedures and attempt, quite rightly in the European Economic and Social Committee's view, to prevent the improper use of banking secrecy and other, seemingly legal, procedures to defraud the treasury.

Both the proposal for a directive on administrative cooperation and the proposal for a directive on assistance for the recovery of claims provide for the possibility that officials from the requesting Member State be present during the administrative enquiries carried out in the requested State. The European Economic and Social Committee considers this form of cooperation adequate, as it is subject to two important conditions: an agreement must be in place between the requesting and the requested authorities, and the officials must act 'in accordance with the laws, regulations or administrative provisions of the requested Member State'. The involvement of a requesting State's officials in investigations carried out in the requested State has precedents in current legislation in the fields of excise duties and VAT, the powers involved in the Commission's proposals are greater, because officials may exercise powers of inspection. On this and on other aspects, the European Economic and Social Committee is of the opinion that the Commission's proposals

uphold national sovereignty.

The taxpayer's obligations to the treasury are upheld in the context of cooperation between States, because this entails the possibility of contesting the legality of investigations and the acts carried out by the authorities. The European Economic and Social Committee suggested that in future, the Commission should consider unifying tax laws to the extent possible.

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Advocate General finds Hungarian vocational training levy incompatible with EC law (*CIBA*)

On 17 December 2009, Advocate General Sharpston issued her Opinion in the *CIBA* case (C-96/08). Under the Hungarian rules, trading companies established in Hungary have to pay vocational training levy on the total amount of wage costs, both in Hungary and abroad. The question in this case is whether the disputed rule is compatible with the principle of freedom of establishment under Articles 43 and 48 EC (which correspond to Articles 49 and 54 Treaty on the Functioning of the European Union ('TFEU'), in force since 1 December 2009) where such vocational training levy is imposed on workers employed through a branch in the Czech Republic, where the tax and social security obligations with regard to such workers are met.

In the Advocate General's view, examination of the Hungarian legislation reveals a restriction arising from the operation of a single tax system that clearly operates to the disadvantage of a Hungarian company seeking to exercise its freedom of secondary establishment by operating abroad via a branch. Such a company must pay tax in its home Member State (Hungary) based in part on the payroll costs of its workforce in the host Member State (Czech Republic), in addition to the obligation to pay a similar charge in the host Member State where the company sets up a branch. The Advocate General also noted that this company may not be able to use the offset facility available under domestic law to reduce the cost of the payment of the levy in the home Member State (Hungary), since all offset arrangements must comply with the specific provisions of the Hungarian legislation setting out the four offset options. According to the Advocate General, this last point pivots on the interpretation of the Hungarian legislation, which is ultimately a matter for the national court.

Advocate General Sharpston identified at least three interrelated disadvantages for such a Hungarian company that operates cross-border as compared with a company that operates exclusively in Hungary.

1. It cannot choose to fund specific training for its employees in the Czech Republic that is directly relevant to its own business needs rather than incurring full liability for the levy, such that it enjoys less flexibility in its choice of strategy.
2. Once it has paid the levy (which will then be applied in general terms to improving the skills level of the Hungarian workforce) it must still ask itself whether in addition it needs to fund training to improve the skills of its own employees. In that sense, it may end up paying not just the two training levies (under Hungarian and Czech law) but also an additional sum in respect of job-specific training (which would not generally be the case for a company based exclusively in Hungary and able to make use of the offset facility).
3. If it does use the offset facility to set up training arrangements in Hungary for its Czech employees, it must then accept the additional costs and administrative burdens associated with transporting its Czech-based workforce to Hungary to take part in the training programme and providing them with accommodation and living allowances whilst they are there.

That seems, in practical terms, to deprive a company that operates cross-border of the possibility of using the offset facility in respect of that part of its workforce that is based in another Member State. The Advocate General concluded that the manner in which the levy is imposed – which flows directly from the tax legislation of a single Member State, Hungary – results in a restriction, because it renders the exercise of the right to freedom of establishment less attractive. Advocate General Sharpston proposed that the ECJ find that there is a restriction on the freedom of establishment for which no justification has been advanced by the Hungarian Government.

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Preliminary questions referred to ECJ on compatibility of French tax on immovable property with EC law (*Prunus*)

Pursuant to Article 990 D et seq. of the *Code Général des Impôts* ('CGI'), companies that own, directly or indirectly, immovable property located in France or rights in such property are subject to an annual 3% tax calculated on the market value of the immovable property or rights in such

property. However, companies resident in France or, since 1 January 2008, in another Member State are entitled to an exemption from this French immovable property tax, whereas companies established in non-Member States are subject to additional requirements in order to benefit from this exemption, i.e. to be resident in a country with which France has concluded a double tax treaty containing an administrative assistance clause or a non-discrimination clause.

On 29 September 2009, the French High Court of Paris referred the following preliminary questions to the ECJ in the *Prunus* case (C-384/09).

1. Whether Articles 56 and 58 EC (i.e. the free movement of capital, currently protected under Articles 63 and 65 TFEU) preclude national legislation such as that laid down by Article 990 D et seq. CGI which imposes on legal persons established outside the EU additional requirements for entitlement to exemption from the French immovable property tax, i.e. to be resident in a country with which France has concluded a double tax treaty containing an administrative assistance clause or a non-discrimination clause, whereas legal persons established in the EU are not subject to such additional requirements.
2. Whether Articles 56 and 58 EC (which correspond to Articles 63 and 65 TFEU) preclude national legislation such as that laid down by Article 990 F CGI which enables tax authorities to hold jointly and severally liable for payment of the French immovable property tax any legal person interposed between the party or parties liable to that tax and the immovable property or rights in such property.

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Preliminary ruling requested from ECJ regarding compatibility of specific German business tax rules with Interest and Royalties Directive (*Scheuten Solar Technology*)

On 14 October 2009, the German Federal Tax Court referred the following questions to the ECJ for a preliminary ruling in the *Scheuten Solar Technology* case (C-397/09).

1. Does Article 1(1) of Council Directive 2003/49/EC of 3 June 2003, on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (the 'Interest and Royalties Directive') preclude a provision under which interest paid on a loan by a company of one Member State to an associated company of another Member State is added to the basis of assessment to trade tax for the first company?
2. If so, is Article 1(10) of the Interest and Royalties Directive to be interpreted as meaning that a Member State has the option of not applying that Directive even where the conditions set out in Article 3(b) in relation to the existence of an associated company have not yet been maintained for an uninterrupted period of at least two years at the time of payment of the interest? Can the Member States rely, in respect of the paying company, directly on Article 1(10) of the Interest and Royalties Directive in those circumstances?

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Developments in the Netherlands: Supreme Court allows application of free movement of capital for Canadian resident individual

On 25 September 2009, the Dutch Supreme Court gave its judgment in a case regarding the application of a facility in the Inheritance Tax Act for a Canadian resident individual ('Interested Party'). In 2001, the father of Interested Party died. His father was a Dutch resident. The inheritance left by the father, amongst others, consisted of (depository receipts for) shares in a Dutch company. The share interest received by Interested Party amounted to 4.13% of the share capital. According to Dutch law, a share interest of that size (< 5%) does not form a substantial interest. In short, the consequence is the Interested Party cannot apply any facility for inheritance tax, whereas the brothers and sisters of Interested Party, who are Dutch residents, can apply the facility.

The Dutch Supreme Court considered an inheritance following death as a cross-border movement of capital. In the Court's view, the free movement of capital with third countries applies due to the size of the share interest in the Dutch company. The Supreme Court referred to the ECJ judgment of 24 May 2007, in the *Holböck* case (C-157/05) in this respect. According to the Supreme Court, the only reason that the facility for inheritance tax cannot be obtained, lies within the fact that Interested Party is not a Dutch resident. The Supreme Court ruled that this formed a forbidden restriction of the free movement of capital. The Dutch measure cannot be justified, as the purpose of the legislation is to facilitate the succession in companies. Therefore, an individual resident in Canada is entitled to equal treatment in the Netherlands based on the free movement of capital

with third countries.

Preliminary comment

This is an important judgment, as here we have a decision from a Dutch domestic court where a non-EU resident receives 'national' or equal treatment based on EC law. Of course, we have various judgments of the ECJ on the free movement of capital with third countries and there is a somewhat lively debate on the question of whether the freedom of establishment takes precedence over the free movement of capital in cases where a majority share interest is held. This is the result of cases such as *Glaxo Wellcome* (C-182/08), *KBC Bank* (C-439/07), *Holböck* (C-157/05), *Burda* (C-284/06), and *Fidium Finanz* (C-452/04), where the question was whether the facts of a case or the nature of the domestic rule is decisive for the applicable EC Treaty Freedom. However, there seems to be little doubt surrounding the application of the free movement of capital with third countries in minority interest cases (such as the 4.13% interest in the case at hand).

On 26 September 2008, the Dutch Supreme Court applied the free movement of capital with third countries to a Dutch company with a currency exchange loss on a Czech participation (minority interest) at the time when Czech Republic was still a third country (see EU Tax Alert edition no. 60, November 2008). In that case, a Dutch company received equal treatment for its investment outside the EU. The Supreme Court judgment of 25 September 2009 now grants EC Treaty protection to third country residents with minority interests in the Netherlands.

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4. VAT

VAT treatment of postal services

In its press release of 2 December 2009, the Council stressed the importance of taking all measures to resolve the political problems with regard to the VAT treatment of postal services before the Third Postal Directive enters into force on 1 January 2011. The Spanish and Belgian Presidencies have been invited to explore and examine all options and to report the progress made at the Ecofin Council meeting in December 2010 at the latest.

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Reversed VAT for emission allowances, mobile phones and electronic circuit devices

In order to combat tax fraud, the Council has agreed, pending the opinion of the European Parliament, on a draft Directive on the basis of which Member States may apply the reverse charge mechanism on greenhouse gas emission allowances. The draft Directive allows Member States to apply this measure until 30 June 2015. No agreement has yet been reached about the application of the reverse charge mechanism to mobile phones and electronic circuit devices. The Commission declared that it would present a proposal for derogation before June 2010. Member States that are currently allowed to reverse the VAT on mobiles phones and electronic circuit devices to the customer will be allowed to do so until agreement is reached on a new Decision or Directive.

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Commission establishes details for VAT refund procedure as of 2010

On 30 November 2009, the Commission adopted an implementation Regulation (No 1174/2009) on the refund of VAT under Council Directive 2008/9/EC. According to Article 9, paragraph 2 of this Directive, the Member State of refund may require the applicant of a request for a VAT refund to provide additional electronic coded information to the extent that such information is necessary due to any restrictions on the right of deduction of input VAT, or for the implementation of a derogation received by the Member State of refund under Articles 395 and 396 of the EC VAT Directive. In the implementation Regulation, the Commission has laid down the technical details for the transmission of the additional information required by the Member States.

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Proposal to allow Lithuania to reverse VAT in specific cases

On 8 December 2009, the Commission provided the Council with a proposal for a Council Decision that authorizes Lithuania, by way of derogation from Article 193 of the EC VAT Directive, to continue to apply the reverse charge mechanism on supplies of timber, and supplies of goods and

services by a taxable person under an insolvency procedure or a restructuring procedure subject to judicial oversight. The derogating measure was initially authorized by Council Decision 2006/388/EC, which expires on 31 December 2009. After adoption of the proposed Decision by the Council, the new measure will be in force until 31 December 2012.

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Slovenia may defer the right of deduction of VAT in case of cash accounting

The Council has authorized Slovenia, by means of an implementing Decision dated 7 December 2009, to continue to postpone the right to deduction of VAT of certain taxable persons until the VAT due by those persons has been paid to the supplier of the goods or services. The authorization is in derogation from Article 167 of the EC VAT Directive.

The taxable persons concerned are those who opted for a cash accounting scheme under which the VAT on their supplies of goods or services becomes chargeable when they receive the payment. Furthermore, under the scheme, their annual turnover may not exceed EUR 400,000 (EUR 208,646 on the basis of the previous authorization). The Decision will apply from 1 January 2010 until the date of the entry into force of a Directive concerning the same matter. In all events, the Decision will apply until 31 December 2012 at the latest.

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Sweden and UK authorized to postpone the deduction of VAT in case of cash accounting

In derogation from Article 167 of the EC VAT Directive, Sweden and the UK were authorized by Council Decision 2007/133/EC scheme to defer the right to deduction of input VAT in respect of taxable persons who opted for a cash accounting, until the VAT due by those persons has been paid to their suppliers. In its implementing Decision of 7 December 2009, the Council decided to extend this derogation measure. The annual turnover of the taxable persons concerned must not exceed SEK 3,000,000 for Sweden and GBP 1,500,000 (previously GBP 1,350,000) for the UK. The Decision will be applicable as of 1 January 2010, and will expire when a Directive enters into force which enables the other Member States to apply the derogation. In all events, the Decision will expire on 31 December 2012 at the latest.

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Commission proposes implementing measures VAT package

On 17 December 2009, the Commission adopted a proposal to recast Regulation 1777/2005. The measures in the proposal are aimed, in particular, at giving legal certainty for both businesses and Member States to a number of non-binding guidelines of the VAT Committee, which guidelines are the outcome of in-depth discussions between Member States. The guidelines relate, inter alia, to the exceptions to the new main rules, and to the prevention of double taxation that could arise as a result of a diverging interpretation of the rules in the VAT package.

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ECJ rules request for refund of foreign VAT may be signed by representative (*Yaesu Europe*)

On 3 December 2009, the ECJ rendered its judgment in the *Yaesu Europe* case (C-433/08). *Yaesu Europe B.V.*, a company established in the Netherlands, applied according to the procedure of the Eight EC VAT Directive for a refund of German VAT at the German Central Federal Tax Office. The application was signed and submitted by the lawyers of *Yaesu Europe B.V.* With the application, the lawyers enclosed an authorization, which empowered the lawyers to act as representatives for the company in the refund procedure.

The German Central Federal Tax Office refused the request for the VAT refund on the grounds that it did not bear the personal signature of the company, which was required on the basis of a provision in national law. After a series of proceedings, the German Federal Tax Court referred preliminary questions to the ECJ regarding the compatibility of this national provision with Article 3, under a of the Eight EC VAT Directive, according to which a taxable person must submit an application modelled on the specimen contained in Annex A to the Directive.

The ECJ ruled that a request for a VAT refund based on the Eight EC VAT Directive does not have to be signed by the taxable person in person but may be signed by a representative, on the following grounds. First, Annex A to the Eight EC VAT Directive indicates that a signature is

required, but it in no way specifies that the signature must be of a specific kind. Furthermore, according to Article 6 of the Eight EC VAT Directive, Member States may not impose any additional obligations on taxpayers other than the obligation to provide information to determine whether the request for the VAT refund is justified. Finally, based on the harmonization aim of the Eight EC VAT Directive, the ECJ indicated that the terms used in Annex A to the Directive must have the same meaning and scope in all Member States such that does not go beyond the requirements specifically provided for. As a consequence, the lawyers of Yaesu Europe B.V. were entitled to sign and submit the request for the VAT refund on behalf of the company.

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5. Customs Taxes and Excise Duties

ECJ ruling on excise duty exemptions for Alumina production (*Commission v Ireland and Others*)

The Commission welcomed the ECJ judgment of 2 December 2009 in the *Commission v Ireland and Others* case (C-89/08), setting aside the judgment of the then CFI (now the General Court) in the *Alumina* case (joined cases T-50/06, T-60/06, T-62/06 and T-69/06). The CFI had annulled a Commission's decision of December 2005, declaring exemptions from the excise duty on mineral oils used as fuel for alumina production in France, Ireland and Italy incompatible with State aid rules and ordering their recovery. The CFI had raised, on its own initiative, the plea that the Commission decision was insufficiently motivated as regards the classification of the measure as new aid and not as existing aid, and had given judgment without discussing the matter with the parties. The ECJ referred the case back to the (now) General Court for examination of the pleas put forward by the three Member States and the two companies seeking annulment of the Commission decision.

Following the Commission's appeal against this judgment, the ECJ held that the contested decision was not rendered invalid by insufficient motivation. The ECJ further ruled that the General Court was entitled to raise the issue of insufficient motivation on its own initiative, but that it should have obtained the parties' observations before reaching a conclusion.

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ECJ rules on the non-preferential origin of steel cables (*Heko Industrieerzeugnisse*)

On 10 December 2009, the ECJ gave its judgment in a case against Heko Industrieerzeugnisse GmbH ('Heko') in the *Heko Industrieerzeugnisse* case (C-260/08). The case concerns the non-preferential origin of steel cables manufactured in North Korea using stranded steel wire originating in China.

In May 2005, Heko requested binding origin information ('BOI') from the German Western Federal Revenue Office for various types of steel cables coming under heading 7312 of the Combined Nomenclature ('CN'), manufactured in North Korea using stranded wire originating in China and also coming under heading 7312 of the CN.

It appears from the documents before the Court that, in order to manufacture those cables, stranded wire, consisting of several wires, is twined together on cabling machines at an undertaking equipped for that purpose in North Korea. Depending on their intended future use, the steel cables are also cut into sections, joined, compressed, filled, flattened, entwined together and/or coated at that undertaking.

On 11 January 2006, the *Bundesfinanzdirektion* issued five BOIs under which the People's Republic of China is designated as the country of origin of the steel cables on the ground that, in the absence of a change in tariff heading, the cabling of the stranded wire culminating in the manufacture of steel cables, carried out in North Korea, did not constitute substantial processing or working within the meaning of Article 24 of the Customs Code.

In order to substantiate its position, the Western Federal Revenue Office relied on rules, known as 'list rules', drawn up by the Commission of the European Communities with the aim of defining the terms in Article 24 of the Customs Code and available on its Internet site. Article 24 of the Customs Code (Regulation (EEC) No 2913/92) provides: '*Goods whose production involved more than one country shall be deemed to originate in the country where they underwent their last, substantial, economically justified processing or working in an undertaking equipped for that purpose and resulting in the manufacture of a new product or representing an important stage of manufacture.*' As is apparent from those rules, goods under heading 7312 of the CN cannot be

regarded as having undergone their last substantial processing or working unless they change tariff heading.

Heko appealed against the Western Federal Revenue Office's decisions to the German Tax Court of Düsseldorf. By judgment of May 2007, that court cancelled the disputed BOIs and ordered the Western Federal Revenue Office to issue BOIs in which the People's Democratic Republic of Korea was to be indicated as the country of origin of the steel cables. According to that court, the list rules are incompatible with the Court's case law and do not constitute a binding legal Community act.

The Western Federal Revenue Office appealed against that ruling to the referring court, claiming that, even though the list rules do not have legal effect, they do, nevertheless provide to some extent an interpretation of Article 24 of the Customs Code. In those circumstances, the German Tax Court of Düsseldorf decided to stay proceedings and refer the following question to the Court for a preliminary ruling: *'Is the only substantial processing or working of goods coming under heading 7312 of the CN which confers non-preferential origin that which has the effect that the product resulting from that processing or working is to be classified under a different heading of the CN?'*

The ECJ ruled with regard to goods classified under heading 7312 of the CN, that 'substantial processing or working' within the meaning of Article 24 of Customs Code, may cover not only such processing or working as leads to the goods which have undergone the process being classified under a different heading of the CN, but also such processing or working as results, without such a change of heading, in the creation of a product with properties and a composition of its own which it did not have before the process.

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ECJ rules on infringement of Community law by not paying customs duties payable on imports of armaments and material for civil and military use (*Commission v Finland, Sweden, Germany, Italy, Greece and Denmark*)

On 15 December 2009, the ECJ gave its judgment in the *Commission v Finland, Sweden, Germany, Italy, Greece and Denmark* cases (C-284/05, C-294/05, C-372/05, C-387/05, C-409/05, C-461/05, C-239/06). The cases concern the non-payment of duties on imports of armaments and material for civil and military use.

The Commission asked the ECJ to declare that Finland, Sweden, Germany, Italy, Greece and Denmark were in breach of their obligations under the Community Customs Code and under various regulations by refusing to pay as own resources of the Community customs duties levied when armaments were imported (and, in respect of Sweden and Italy, also dual-use material, for civil and military use). Germany, for its part, paid a sum of EUR 10,803 million – on a without prejudice basis and without providing a breakdown of the sum according to imports and periods – and then refused to send such information to the Commission. The infringements concern the period from 1 January 1998 to 31 December 2002, whereas, from 1 January 2003 – in order to take into consideration the protection of military confidentiality by Member States – specific administrative procedures were provided for in order to allow the suspension of import duties on such material.

In essence, the Member States stated that the justification for their refusal to make payment was the fact that the collection of customs duties would have threatened their essential security interests. The Court observed that there was no provision of the Community customs legislation which, in respect of the period from 1 January 1998 to 31 December 2002, provided for any specific exemption from customs duties on imports of products of that type. On the contrary, the suspension of customs duties on certain weapons and military equipment from 1 January 2003 confirmed that the Community legislature started from the assumption that an obligation to pay those customs duties existed prior to that date.

The ECJ declared that, while it is true that it is for Member States to take the appropriate measures to ensure their internal and external security, those measures are not entirely outside the scope of Community law, which provides for express derogations applicable in situations which may involve public safety, but exceptionally and in clearly defined cases which must be interpreted strictly. The Court also stated that a Member State cannot plead by way of justification the increased costs of military material because of the application of customs duties: on the contrary, a Member State cannot avoid compliance with the obligations of joint financing of the Community budget.

Further, the justification based on confidentiality requirements contained in agreements entered into with exporting States cannot be accepted because the customs procedures involve the active involvement of Community and national officials, who are all bound by an obligation of

confidentiality which is capable of protecting the essential security interests of Member States. Moreover, the obligation to facilitate the achievement of the Commission's task – of ensuring compliance with the EC Treaty – by making available to it the documents necessary to permit inspection to ensure that the transfer of the Community's own resources is correct does not mean that Member States may not, on a case-by-case basis and by way of exception, restrict the information sent to certain parts of a document or withhold it completely.

More specifically, in the two cases against Sweden and Italy, which relate to duty-free imports of dual-use material – for both civil and military use – the Court stated that the reason why there was no justification based on the need to safeguard the Member States' interests apply a fortiori to imports of material for dual use, whether or not it was imported exclusively for military purposes. Lastly, the Court rejected the justification based on the Commission's prolonged lack of action and the argument that adoption of the regulation on suspension of duties was tacit acceptance of the existence of an appropriate derogation. The Commission had not at any stage of the proceedings abandoned its position in principle, and it had always expressed its firm intention to maintain its claim to the collection of customs duties which should have been paid for periods prior to the introduction of the procedures for suspension.

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ECJ rules upon the tariff classification of gelatine capsules (*Swiss Caps*)

On 17 December 2009, the ECJ gave its judgment in the joined *Swiss Caps* cases (C-410/08 to C-412/08). The cases concern the classification of Omega 3 soft-gelatine capsules, wheat-germ oil capsules and black cumin oil capsules, all not put up for resale.

The ECJ ruled as follows:

The CN, set out 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 (EC) No 2388/2000 of 13 October 2000, must be interpreted as meaning that:

- edible preparations presented in the form of capsules containing 600 mg of cold-pressed concentrated fish oil and 22.8 mg of concentrated vitamin E in a casing consisting of 212.8 mg of gelatine, 77.7 mg of glycerol and 159.6 mg of purified water and intended for use as a food supplement;
- edible preparations presented in the form of capsules containing 580 mg of wheat-germ oil in a casing consisting of 250 mg of granulated starch and intended for use as a food supplement; and
- edible preparations presented in the form of capsules containing 500 mg of cold-pressed black cumin oil, 38.7 mg of soya oil, 18.8 mg of vitamin E, 16 mg of butterfat, 10 mg of lecithin, 8.2 mg of wax, 8 mg of calcium pantothenate, 0.2 mg of folic acid and 0.11 mg of biotin in a casing consisting of 313.97 mg of gelatine mass (47.3% gelatine, 17.2% glycerine, 35.5% water), 4.30 mg of paste consisting of 50% titanium dioxide and 50% glycerine, and 1.73 mg of paste consisting of 25% quinoline yellow lacquer and 75% glycerine and intended for use as a food supplement must be classified under heading 2106 of the abovementioned CN.

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Commission authorises Polish tonnage tax scheme

On 18 December 2009, the Commission decided to authorise the introduction of a Polish tonnage tax scheme, which enables shipping operators to pay a flat-rate tax based on the tonnage of their fleet, instead of a corporation or personal tax. This scheme allows for maritime activities to be eligible for tonnage tax, as well as dredging if at least 50% of the operational time of a dredger constitutes maritime transport, i.e. direct transport of freight and/or passengers. In addition, the Commission accepted the inclusion of towage activities in this scheme but only on condition that at least 50% of the operational time of a tugboat is dedicated to maritime transport activities. The Commission also approved the inclusion in the scheme of management activities since they fulfil all the requirements of the new Guidelines on State aid to ship management companies.

The Commission assessed all the ring-fencing measures put in place as sufficient in order to avoid any possible 'spill-over' between activities eligible and non-eligible for tonnage tax as well as between companies from the same group which are tonnage tax beneficiaries and those which are not. The Commission considered that the scheme is compatible with the internal market and can contribute to the Community's interests in the field of maritime policy. The approved scheme may be applied as from 1 January 2011.

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