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1. Top News

June 2010

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Commission approves of Finnish REIT regime

After a preliminary investigation of more than 14 months, the Commission has decided to approve a Finnish regime that exempts real estate investment trusts from corporate tax in order to stimulate investment in affordable rental housing. No single shareholder may own 10% or more in a qualifying REIT, a minimum of 80% of the REIT's gross income must come from rents, and at least 90% of annual profits must be distributed as dividend.

From the 12 May 2010 press release, it seems that the Commission did not consider the regime as aid as it creates transparency, i.e. profits made by the trusts will be taxed at shareholders' level comparable to the situation of direct investment in the real estate market by private investors. However, the Commission demanded of the Finnish government that it cancel its plans to allow for a provision that would allow for the reservation of 30% of a REIT's profit for reinvestment, as it would give rise to incompatible aid.

Preliminary comments

With this decision, the Commission indicates its willingness to accept regimes that provide full transparency for indirect investment, provided that the regimes do not lead to any delay in taxation such as the creation of a special tax reserve that might benefit specialised investment as in real estate. It should also be pointed out that the Commission's ruling of non-aid instead of compatible aid effectively means that the ruling is not restricted to REITs with a particular public/social function as in the case at hand.

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CJ ruling on compatibility of the Netherlands merger exemption with Merger Directive (*Zwijenburg*)

On 20 May 2010, the CJ rendered its judgement in the *Zwijenburg* case (C-352/08). This case concerns the interpretation of the anti-abuse provision in the Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (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 on 31 July 2008, 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.

A first observation concerns the jurisdiction of the CJ, since the preliminary question referred to a provision of national law which applies within a purely national context. In line with established case law, such as the *Leur-Bloem* case (C-28/95), the CJ considered that it did have jurisdiction in this case, since the Dutch legislature had decided, when transposing the provisions of the Merger Directive, to apply the tax treatment provided for by that Directive also to purely internal situations, with the result that domestic and cross-border restructurings are subject to the same tax treatment.

The CJ considered that the Merger Directive applies without distinction to all mergers, divisions, transfers of assets or exchanges of shares, irrespective of the reasons for those operations, whether financial, economic or fiscal. However, the reasons for the proposed transaction are important in the implementation of Article 11(1) of the Merger Directive. Under this article, Member States may refuse to apply, or may withdraw the benefit of, all or any part of the provisions of that Directive, *inter alia*, where the exchange of shares has tax evasion or tax avoidance as its principal objective or as one of its principal objectives. That same provision also provides that the fact that the operation is not carried out for valid commercial reasons, such as the restructuring or

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rationalisation of the activities of the companies participating in the operation, may constitute a presumption that the operation does have such an objective. According to the CJ, Article 11(1)(a) of the Merger Directive should be interpreted restrictively, since it sets out an exception.

From the reference to the restructuring or rationalisation of the activities of the companies participating in the operation in question, in which case there can be no presumption of tax evasion or tax avoidance, the CJ concluded that the provision was clearly limited to mergers and other reorganizational operations and that it was applicable only to taxes arising from those operations. It concluded that only the taxes expressly referred to in the Merger Directive (i.e. corporate income tax and personal income tax) can fall within the scope of Article 11(1)(a) the Merger Directive. In addition, the CJ found nothing in the Merger Directive to suggest that it intended to extend the facilities of the Directive to other taxes, such as real estate transfer tax, which is a tax levied on the acquisition of real property.

The CJ concluded that Article 11(1)(a) of the Merger Directive is to be interpreted as meaning that the favourable arrangements of that Directive may not be withheld from a taxpayer who has sought, by way of a legal stratagem involving a company merger, to avoid the levying of a tax such as real estate transfer tax, where that tax does not fall within the scope of application of that Directive.

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Preliminary questions referred to CJ by the Portuguese Supreme Court on the concept of valid commercial reasons for the purpose of the anti-abuse provision under the Merger Directive (*Foggia*)

On 10 March 2010, the Portuguese Supreme Court referred a case to the CJ concerning the interpretation of the anti-abuse provision provided in Article 11(1)(a) of the Merger Directive, which currently corresponds to Article 15(1)(a) of Council Directive 2009/133/EC of 19 October 2009 (codified version). The case is now pending before the CJ as the *Foggia* case (C-126/10) and it concerns the meaning of the expressions 'valid commercial reasons' and 'restructuring or rationalisation of the activities' of companies participating in operations covered by the Merger Directive'.

The facts of the case refer to 2003 and are relatively straightforward: a Portuguese bank had four Portuguese holding companies (under the form of an SGPS – *Sociedade Gestora de Participacoes Sociais*). Such bank decided to eliminate part of those holding companies and, for that purpose, three holding companies merged, by incorporation, into the fourth holding company, Foggia SGPS. One of the incorporated holding companies had incurred considerable losses in the amount of EUR 3,500,000.00. Following the requirements set forth in the Portuguese Corporate Income Tax Code ('CITC'), Foggia SGPS submitted an application to the Ministry of Finance for the transfer of those tax losses of the incorporated company. The granting of such authorization for the transfer of losses under restructuring transactions is subject to certain conditions, amongst which, the existence of valid commercial reasons.

The request submitted by Foggia SGPS was denied by the Ministry of Finance. According to its understanding, there was no evidence of valid commercial reasons for the transaction from the perspective of the acquiring company (even if the merger did indeed have a positive effect in terms of the overall cost structure of the group as it would allow to reduce the administrative and management costs). In fact, considering that the acquired company had developed almost no activity as a holding company, had no financial holdings and its net value was almost irrelevant when compared to that of the acquiring company, the positive effects of the merger were insignificant from the perspective of the acquiring company Foggia SGPS. Therefore, the only interest in the transaction was, according to the Ministry of Finance, to be permitted to transfer the substantial amount of losses.

Foggia SGPS appealed this decision. Considering that 'valid commercial reasons' is an EU concept, the Portuguese Supreme Court decided to refer the case to the CJ, raising for that purpose two questions:

1. What is the scope and range of Article 11(1)(a) of the Merger Directive, notably the meaning of the terms 'valid commercial reasons' and 'restructuring or rationalisation of the activities of the companies participating in the operations' covered by the Merger Directive.
2. Whether it is line with such provision the understanding followed by the Portuguese tax authorities that the lack of valid commercial reasons should be evaluated from the perspective of the acquiring company (Foggia SGPS), to whom there was no apparent commercial interest in the acquisition since the acquired company had developed no activity has a holding company, had no financial holdings and would consequently transfer only substantial losses, even if it is recognized that the merger had a positive effect in terms of

the costs structure of the group.

Preliminary comments

The outcome of this case is expected to be most interesting. First, because the CJ will be required to deal with the concept: what should be the meaning of the anti-abuse provision provided in Article 11(1)(a) (currently Article 15(1)(a)) of the Merger Directive. In addition, it will be most relevant to analyse the approach the CJ takes in such analysis, namely whether the CJ will follow somehow the approach elected by the Portuguese tax authorities (i.e. that valid commercial reasons should be evaluated in the perspective of the acquiring company (Foggia SGPS) and not in the perspective of the whole group), or whether it will take a different approach. This is relevant since the interpretation followed by the Portuguese tax authorities may not be limited to a Portuguese level but may also be followed by tax authorities in other Member States.

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Commission publishes report on removing tax obstacles to cross-border venture capital investment

On 30 April 2010, the Commission published a report which outlines the double taxation problems that arise when venture capital is invested cross-border, as well as possible solutions. Venture capital is a vital source of growth for small and medium enterprises ('SMEs'). Therefore, facilitating venture capital investment within the EU is crucial for good economic growth. The report sets out the findings and recommendations of an independent group of EU tax experts, which was set up by the Commission in 2007 to look at how to remove the main tax barriers to cross-border investment in venture capital. Two main problems are identified in the report, and possible solutions are recommended.

First, the local presence of a venture capital fund manager in the Member State in which an investment is made may be treated as a taxable presence (i.e. a permanent establishment) of the fund or of the investors in that Member State. This could lead to double taxation if the return on the investment is also taxed in the country or countries of location of the fund or the investors. The EU tax experts proposed that a venture capital fund manager should not be considered as creating a taxable presence for the fund or investors in the Member State where the investment is made. This would reduce double tax problems for cross-border venture capital investment.

Second, it was found that venture capital funds may currently be treated in very different ways for tax purposes by the different Member States. A fund may, for example, be treated as transparent in one Member State and non-transparent in another. Again, this can lead to double taxation. The EU tax experts therefore suggested that Member States should agree on a mutual recognition of the tax classification of venture capital funds.

The Commission is to present the report to the Member States' tax authorities for input into the ongoing work of looking at how to improve the Internal Market for SMEs. The Commission will now consider how best to follow up on the findings in the report, in line with its broader agenda to eliminate double taxation in the EU.

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2. State Aid/WTO

CJ reiterates strictness of State aid recovery regime (*Scott and Kimberly Clark*)

In its Judgement of 20 May 2010 in *Scott and Kimberly Clark* (C-210/09), the then ECJ pointed out that the obligation for an immediate and effective execution of a Commission's recovery order should go hand in hand with effective legal protection as a principle of EU law. In the case at hand, recovery had been completed by an administrative act (assessment) that had a procedural defect. The aforementioned obligation does not stand in the way of a national court annulling such act if it is possible to rectify that defect under national law. However, such annulment may not have the effect of causing a provisional repayment of money recovered to the original aid recipient, as it would compromise the immediate and stable restoration of the previously existing situation (prior to any aid being granted) by re-establishing the unfair competitive advantage that the Commission's order aims to take away.

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Commission appeals *EDF* decision on conversion of tax claim into capital

Under case number C-124/10 P, the Commission filed an appeal against the General Court's

decision in the *Electricité de France* case (T-156/04 of 15 December 2009). According to the *EDF* decision, the Commission should check whether the State acted as a private investor under normal market conditions if it decides to waive a tax claim of a public company of which it is the sole shareholder, as the State could decide to use taxes collected for the recapitalisation of the company which would have the same effect as an immediate waiver. The Commission's decision in this case had been annulled because of its failure to conduct this latter assessment because in its view, the private investor test should not be applied to the conversion of a tax claim into capital.

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Commission takes next step in French recovery procedure

On 5 May 2010, the Commission sent a letter of formal notice to France in respect of its partial failure to recover State aid that arose from a two-year tax exemption for companies that had been taken over in the process of an insolvency procedure. Although France had taken several steps, aid had only been recovered from 27 of the 200 companies involved. In nine other cases, France had registered its recovery claim as part of bankruptcy proceedings. Furthermore, some companies did not have to pay at all because of calculations made to show that tax benefits received were below the *de minimis* level. As far as the remaining companies were concerned companies – in particular the main beneficiary of the scheme which had already received restructuring aid on the pre-condition of repayment of the aid received under the aforementioned scheme – effective recovery had not yet taken place. If France continues its failure to comply in full with the Commission's recovery decision, the latter may take France to the CJ and ask that fines be imposed. This would be the second time this case would go to the CJ, as it had already given one ruling on France's failure to comply in November 2008.

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Commission closes investigation into VAT arrangement after over nine years

On 26 May 2010, the Commission closed its investigation into an arrangement between the Belgian tax authorities and UMICORE SA. The company received a VAT assessment of around EUR 20 million. After negotiations with Belgian tax authorities, it ended up paying a fine of EUR 10 million instead. Because of the possibility of an undue rebate in VAT payments, a State aid investigation was opened in 2003. It took until 2009 before seized tax files and evidence relating to this agreement were released by the Brussels public prosecutor's office, allowing the Belgian government to forward this evidence to the Commission. After an in-depth investigation, the Commission concluded that a VAT rebate was possible in this particular case and that the settlement agreement did not give rise to any tax benefit. In the absence of aid, the investigation was closed.

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3. Direct Taxation

CJ concludes Italian tax rules on quantitative and territorial limits on deductibility of costs related to studies in non-resident university compatible with EU law (*Zanotti*)

On 20 May 2010, the CJ rendered its judgment in the *Zanotti* case (C-56/09), without an Opinion from Advocate General Kokott. The question in this case was whether the Italian income tax law (Article 15(1)(e) of Decree No 917 of the President of the Republic of 22 December 1986 and of Point 1.5.1 of Circular No 95 of the Ministry of Finance of 12 May 2000), which imposes a cap on the deductibility of costs related to studies in non-resident universities while allowing such tax deduction in respect of tuition fees payable to Italian State universities offering similar courses, is in conflict with EU law.

Mr Zanotti is an Italian citizen who came to the Netherlands in 2003 to pursue a master program in international tax law at Leiden University. Mr Zanotti tried to deduct the tuition fees paid to the University in his Italian tax return for fiscal year 2003. The Italian Revenue allowed a deduction up to the maximum amount set for the corresponding costs of attending similar courses at the national State University nearest to the taxpayer's residence for tax purposes. Amongst others, Mr Zanotti argued before the Italian Regional Tax Commission of Rome that the restrictions imposed by the Italian legislation are precluded by the freedom to provide services (Article 56 TFEU) and the right of EU citizens to move and reside freely within the EU (Article 21 TFEU). In turn, the Italian court referred a preliminary question to the ECJ on 9 February 2009 (see EU Tax Alert, edition 66, May 2009).

The CJ held that national legislation which allows taxpayers to deduct from gross tax the costs of attending University courses provided by Universities situated in that Member State but excludes generally that possibility for University tuition fees incurred at a private University established in another Member State is incompatible with EU law. Conversely, if the national legislation allows a partial deduction up to the maximum amount set for the corresponding costs of attending similar courses at the national State University nearest to the taxpayer's residence for tax purposes (i.e. quantitative and territorial limits), that legislation does not constitute an obstacle to the freedom to provide services and the right of EU citizens to move and reside freely within the EU. The Court had previously held in the *Schwarz and Gootjes-Schwarz* case (C-76/05) that, in order to avoid an excessive financial burden, it is legitimate for a Member State to limit the amount deductible in respect of tuition fees to a given level, corresponding to the tax relief granted by that Member State, taking account of certain values of its own, for attendance at educational establishments situated in its territory.

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Advocate General finds higher hunting levy for Swiss nationals compatible with EU law (*Hengartner and Gasser*)

On 20 May 2010, Advocate General Jääskinen gave his Opinion in the *Hengartner and Gasser* case (C-70/09). The questions in this case were whether hunting is a self-employed activity within the meaning of Article 49 TFEU (former Article 43 EC), even if that activity is not intended to make an overall profit, and whether third country nationals from Switzerland can rely on the EU-Switzerland Agreement on the Free Movement of Persons concluded in 1999, which came into force on 1 June 2002, to invoke protection against a potentially discriminatory hunting levy under the freedom of establishment provision.

Mr. Hengartner and Mr. Gasser are Swiss residents and nationals who leased the right to hunt in Austria for six years, from 2002 to 2008. They were subject to a higher hunting levy than the levy imposed on EU citizens or Austrian residents. They appealed a decision of the Austrian tax administration and, on 17 February 2009, the Austrian Higher Administrative Court decided to refer the case to the Court for a preliminary ruling.

According to Advocate General Jääskinen, it is indisputable that third country nationals cannot invoke protection under the freedom of establishment provision. He also observed that the scope of the provision on the freedom of establishment and freedom to provide services, as well as the general non-discrimination prohibition under the EU-Switzerland Agreement on the Free Movement of Persons are much more restricted than under the TFEU. Therefore, the Advocate General concluded that the EU-Switzerland Agreement on the Free Movement of Persons does not preclude national legislation according to which a hunting levy is imposed on Swiss nationals at a higher rate than on EU citizens.

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Preliminary question referred to CJ on certain rules regarding the statute of limitation in the Belgian inheritance tax code

On 15 March 2010, the Court of First Instance of Leuven referred a preliminary question to the CJ in the *Halley* case (C-132/10). The preliminary question concerns the Belgian rules on the statute of limitation for claims regarding a so-called 'control estimation' of the value of certain goods of an estate and the inheritance tax, interest and fines that are due if the valuation of these goods in the inheritance tax declaration is too low.

For goods that are subject to such 'control estimation', the limitation period for the above claims is two years as of the filing of the inheritance tax declaration. Only goods that are situated in Belgium are subject to such 'control estimation'. For goods that are not subject to such 'control estimation', only a claim regarding the inheritance tax, interest and fines that are due in the case of an undervaluation of the goods, can be filed. The limitation period for these claims is ten years as of the filing of the inheritance tax declaration.

Via its preliminary question, the Court of First Instance of Leuven, more specifically, wishes to know whether these rules are compatible with Articles 26, 49, 63 and 65 TFEU, given that the limitation period in respect of inheritance tax payable on registered shares is two years if the company's effective centre of management is in Belgium, whereas it is ten years if the company's effective centre of management is not in Belgium.

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Commission refers Austria to the CJ over discriminatory rules on fiscal

representatives (*Commission v Austria*)

On 3 June 2010, the Commission decided to refer Austria to the CJ in the *Commission v Austria* case, since Austria had failed to reply satisfactorily to the reasoned opinion sent by the Commission on 14 May 2009 (see EU Tax Alert, edition no. 67, June 2009). The Commission considers that the Austrian rules which request foreign investment funds, real estate funds and credit institutions to appoint a fiscal representative result in discriminatory treatment. The Commission also considers that the prohibition for foreign credit institutions and certified public accountants to be appointed as fiscal representatives for investors in investment funds or real estate funds are discriminatory and incompatible with the freedom to provide services (Article 49 TFEU and Article 36 EEA).

Under Austrian law, domestic credit institutions managing domestic investment funds or real estate funds are not required to appoint a fiscal representative. On the contrary, foreign investment funds and real estate funds must always appoint a fiscal representative when carrying out operations in Austria. In addition, the fiscal representatives appointed must always be established in Austria. The Commission considers that these rules restrict the freedom to provide services and constitute direct discrimination based on the place of establishment of service providers.

The Commission recently sent similar reasoned opinions to Spain (see EU Tax Alert, edition no. 76, February 2010) and Belgium (see EU Tax Alert, edition no. 78, April 2010).

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Commission takes Germany to the CJ over discriminatory taxation of foreign pension institutions (*Commission v Germany*)

On 3 June 2010, the Commission decided to refer Germany to the CJ on the *Commission v Germany* case, since Germany had failed to reply satisfactorily to the reasoned opinion sent by the Commission on 29 October 2009 (see EU Tax Alert, edition no. 72, November 2009).

In Germany, dividends paid by German companies to German 'Pensionskassen' are either subject to a reduced withholding tax rate, or the 'Pensionskasse' can benefit from a partial refund of the withholding tax paid. However, similar institutions established elsewhere in the EU and in the EEA cannot benefit from this reduced rate or partial refund.

For another category of German pension institutions, the 'Pensionsfonds', the dividends received are taken into account in the annual tax assessment procedure and are taxed on a net basis at the general corporate tax rate of 15%. However, dividends paid from Germany to similar foreign institutions are subject to a final withholding tax of 25% on the gross dividend, without the possibility of deducting any costs. A similar distinction is made between interest payments paid to 'Pensionskassen' and 'Pensionsfonds' or to a foreign pension institution.

If a Member State levies a higher tax on dividends or interest paid to foreign pension funds, these funds might be dissuaded from investing in companies in the Member State concerned. Equally, companies established in that Member State might have difficulty attracting capital from foreign pension funds. Higher taxation of foreign pension funds may thus restrict the free movement of capital, as protected by Article 63 TFEU and Article 40 EEA. The Commission is not aware of any justification for such restrictions.

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Commission refers Portugal to the CJ over discriminatory taxation of outbound dividends (*Commission v Portugal*)

On 3 June 2010, the Commission decided to refer Portugal to the CJ in the *Commission v Portugal* case. Portuguese tax rules may in certain cases lead to higher taxation of dividend payments to foreign companies (outbound dividends) than dividend payments to domestic companies (domestic dividends). While the legislation provides for no or only very low taxation of domestic dividends, outbound dividends are subject to withholding taxes of up to 20%. The Commission considers that these rules restrict both the free movement of capital and the freedom of establishment.

In the *Denkavit* ruling of 14 December 2006 (C-170/05), the Court confirmed the principle that outbound dividends cannot be subject to higher taxation in the source State than domestic dividends. However, according to this ruling, it may be relevant to take into account whether the State of residence of the parent company gives a tax credit for the withholding tax levied by the source State. The Commission will take this ruling into account when drafting the application to the CJ.

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Commission publishes report with numerous tax policy recommendations

On 10 May 2010, the Commission published a 107-page report on 'A New Strategy for the Single Market'. The key tax policy recommendations addressed by the Commission in this report are as follows:

1. further work on the elimination of tax barriers within the single market, modernising e-invoicing rules, updating rules on cross border relief, introducing a binding dispute settlement mechanism covering double taxation suffered by individuals and reviewing the Savings directive;
2. work towards a common definition of the corporate tax bases and move forward with the work of the code of conduct group on business taxation;
3. reform VAT rules in a single market-friendly way;
4. develop the area of environmental taxation in the broader context of tax policy and its impact on growth and employment;
5. agree on the establishment, at the initiative of the Commission, of a Tax Policy Group chaired by the Commissioner in charge of taxation and composed of personal representatives of the Member States Finance Ministers as a forum for strategic and comprehensive discussion of tax policy issues.

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Commission formally asks Belgium to modify discriminatory provisions on taxation of inbound dividends and foreign investment companies

On 3 June 2010, the Commission sent two reasoned opinions to Belgium on discriminatory aspects of its taxation of inbound dividends and foreign investment companies. According to the Commission, these discriminations are incompatible with Articles 49, 54 and 63 TFEU, and with the corresponding Articles 31, 34 and 40 EEA

The first request refers to Belgian rules regarding certain inbound dividends received by natural persons. Under Belgian law, residents in Belgium pay a tax rate of 15% on dividends paid by a Belgian company of which the majority of the shares are held by natural persons or of which part of the capital is contributed by a private investment company established in Belgium. Dividends paid out by similar companies resident in other EEA countries are subject to a tax rate of 25%. The Commission considers that the Belgian provisions are discriminatory and restrict the free movement of capital and the freedom of establishment.

The second reasoned opinion refers to legislation which discriminates against foreign investment companies. Under Belgian law, Belgian investment companies do not effectively pay tax on their Belgian-sourced interest and dividend income. They are given a refund of any Belgian withholding taxes on their Belgian-sourced interest and dividend income. Foreign investment companies have to pay withholding taxes of 15% or 25% on their Belgian-sourced interest and dividend income and cannot claim refunds. The Commission considers that the Belgian law is discriminatory and restricts the free movement of capital and the freedom of establishment.

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4. VAT

CJ concludes France may selectively apply the reduced VAT rate on specific funeral services (*Commission v France*)

On 6 May 2010, the CJ rendered its decision in the *Commission v France* case (C-94/09). The case concerns the application of the reduced VAT rate in France on specific elements of services provided by undertakers. More specifically, France chose to apply the reduced VAT rate solely on the transportation of the body by vehicle whereas other funeral services are taxable at the standard VAT rate. The Commission is of the opinion that all services rendered by undertakers constitute a single complex transaction for VAT purposes and should, therefore, be subject to the same VAT rate.

The CJ indicated that the reduced VAT for funeral services is optional. As a consequence, Member States have the possibility of limiting the application of that reduced VAT rate to specific aspects. According to the CJ, this restriction of the application is consistent with the principle that exemptions or derogations must be interpreted restrictively. Furthermore, the CJ ruled that the criteria on the basis of which services qualify as a single transaction are not decisive with regard to

the discretion of a Member State to apply a reduced VAT rate. Therefore, it was not necessary to examine whether the supply of services by undertakers must be regarded as a single transaction. Finally, the CJ ruled that the transportation of a body by vehicle constituted a specific element in the supply of services by undertakers. Consequently, the CJ dismissed the action brought by the Commission.

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Advocate General holds that no specific timeframe applies for transactions to qualify as an intra-Community supply (X)

On 6 May 2010, Advocate General Kokott rendered her opinion in the X case (C-84/09). The case concerns X, a private individual, who intended to purchase a sailing boat in the UK that qualifies as a means of transport in accordance with Article 2, second paragraph of the VAT Directive. Subsequently, X intended to use the sailing boat for recreational purposes for three to five months and for more than 100 hours in either the UK or another Member State than Sweden. After that, the boat was to be sailed to Sweden.

The procedure revolves around the question whether the sailing boat has to be transported out of the State of origin within a certain period of time for the sale to qualify as an intra-Community supply (in either the UK or another Member State than Sweden) followed by an intra-Community acquisition (in Sweden). Furthermore, the referring court wanted to know when a means of transport is 'new' in accordance with article 2, second paragraph under b of the VAT Directive.

According to the Advocate General, the qualification of a transaction as an intra-Community supply followed by an intra-Community acquisition does not solely depend on the condition that the sailing boat leaves the Member State of origin or arrives in the Member State of destination within a certain period of time. All objective circumstances and the intended final use of the goods by the purchaser should be taken into account. Furthermore, the Advocate General is of the opinion that the time of supply in the Member State of origin is decisive in order to decide whether a means of transport is 'new' in accordance with article 2, second paragraph under b of the VAT Directive.

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Advocate General holds UK restriction on the deduction of input VAT related to financial services and insurance services in third countries compatible with EU VAT law (*Commission v United Kingdom*)

On 20 May 2010, Advocate General Jääskinen rendered his Opinion in the *Commission v United Kingdom* case (C-582/08). According to a provision in UK VAT law, taxable persons established in third countries are not allowed to deduct input VAT if they carry out financial and insurance transactions in third countries. The provision is based on a literal interpretation of Article 2, first paragraph, of the Thirteenth EU VAT Directive according to which, VAT is deductible in so far as goods or services are used for the purposes of transactions contained in Article 17, third paragraph, under a and b of the Sixth EU VAT Directive. No express reference is made to the financial and insurance services as indicated under c of the latter Article. The Commission argued, however, that financial and insurance transactions should be read into Article 2, first paragraph, of the Thirteenth EU VAT Directive because such an obligation is inherent to the logic of the VAT system.

The Advocate General indicated that on the basis of a literal interpretation of Article 2, first paragraph, of the Thirteenth EU VAT Directive, no refunds are allowed for third country persons carrying out financial and insurance transactions. Furthermore, according to the Advocate General, it cannot clearly be ascertained from the purpose of the legislative history of this article that the financial and insurance services should be read into the provision, as the Commission argues. Finally, in the opinion of the Advocate General, it is unreasonable for the Commission to start an infringement procedure over this matter while it should have used its right of legislative initiative to remedy the situation.

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Preliminary questions referred to CJ regarding reduced VAT rate applicable to construction works (*Belpolis Benelux*)

On 3 March 2010, the Court of First Instance of Brussels referred two preliminary questions to the CJ in the *Belpolis Benelux* case (C-114/10). The questions concern the reduced VAT rate (6%) applicable to construction works. With its first question, the Court wishes to know if the Belgian rules violate Article 56 TFEU by only applying the reduced VAT rate if the contractor is a 'registered' contractor in Belgium in accordance with the Belgian rules in this regard included in the

ITC Code. With its second question, the referring court wishes to know if the above rules contravene the principle of fiscal neutrality and/or the general EU law principle of equal treatment.

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Preliminary questions referred to CJ regarding reduced VAT rate applicable to construction works (*Knubben Dak-en Leidekkersbedrijf*)

On 11 January 2010, the Court of First Instance of Brussels referred two preliminary questions to the CJ in the *Knubben Dak-en Leidekkersbedrijf* case (C-114/10). The questions concern the reduced VAT rate (6%) applicable to construction works. With its first question, the Court wishes to know if the Belgian rules violate Article 56 TFEU by only applying the reduced VAT rate if the contractor is a 'registered' contractor in Belgium in accordance with the Belgian rules in this regard included in the ITC Code. With its second question, the referring court wants to know if Article 56 TFEU precludes the Belgian rule according to which registration as a contractor in Belgium applies fully and identically to Belgian service providers and to service providers established in another Member State.

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Commission calls on Belgium to amend its legislation on the reduced VAT rate for certain transactions involving buildings

On 3 June 2010, the Commission gave Belgium two months to amend its legislation applying, subject to certain conditions, the 6% reduced rate to supplies of residential buildings and building works. Under Belgian law, a reduced rate is applied to the first EUR 50,000, whereas the balance of the taxable amount remains subject to the standard rate of 21%.

The EU VAT Directive lists the operations which may be subject to the 6% reduced rate of VAT. They include the 'provision, construction, renovation and alteration of housing, as part of a social policy'. Belgian law provides for the application of the reduced rate of VAT to the first EUR 50,000 without, however, any reference to 'social policy'. Because the scheme is general in nature, the Commission considers it outside the scope of the restrictive list figures in the EU VAT Directive.

The EUR 50,000 threshold specified in Belgian law does not serve to differentiate between homes eligible for the reduced rate of VAT and those subject to the 21% standard rate. It simply places a ceiling on the financial advantage accorded by the State. The Commission considers, moreover, that a taxable amount cannot be artificially split so that one part is subject to a reduced VAT rate and the other to a standard rate. Doing so would, in practice, lead to multiple rates, whereas the EU VAT Directive in principle provides for the application of no more than two reduced rates in addition to the standard rate.

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Developments in Luxembourg: VAT exemption on outsourced management services

Article 44(1)(d) of the Luxembourg VAT law (implementing Article 135(1)(g) of the EU VAT Directive 2006/112), exempts from VAT management services rendered to investment funds under the supervision of the CSSF (Luxembourg regulator) as well as Luxembourg pension funds, Luxembourg SICARs (investment company in risk capital) and securitization vehicles.

The ECJ clarified in its judgment in the *Abbey National* case (C-169/04) that the concept of management services should cover services aimed by the second subparagraph of Article 5(2) of Directive 85/611 and its Annex II which mentions three main functions, i.e. investment management, administration and marketing. This decision was implemented in Luxembourg by the Circular no. 723 issued by the Luxembourg VAT administration on 29 December 2006. Consequently, the exemption is available for services rendered directly to the investment funds such as administrative services, portfolio management services and custody bank services except the 'control and supervision' services liable to VAT at 12%.

The treatment of 'delegated' or 'outsourced' services is more delicate. The Circular (Circular no. 723 bis), released by the Luxembourg VAT administration on 30 April 2010, reminds of the principles applicable in this respect. The Circular indicates that the exemption is available for management services performed by a third party manager if these services, viewed broadly, form a distinct whole, and are specific to, and essential for, the management of those funds. On the contrary, the exemption is not applicable to purely material or technical services, such as putting an IT system or furniture at disposal, or to isolated service. Unfortunately, the Circular does not provide an example of isolated service or further guidance regarding this concept.

Preliminary comments

Circular no. 723 bis refers expressly to Circular no. 723 of 29 December 2006, and to the case law of the Court of Justice. Even if the background and the motivation of this new Circular remain unclear, it seems that it could not be seen as a change to the long-standing approach of the Luxembourg VAT administration. It could, however, serve as a reminder for some service providers who have applied the VAT exemption too broadly. Such cases seem, however, limited to some specific and isolated services. It would be interesting to see further developments.

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5. Customs Taxes and Excise Duties

CJ rules on the tariff classification of an adapter containing a memory chip (*Data I/O*)

On 20 May 2010, the CJ rendered its judgment in the *Data I/O* case (C-370/08). The case concerns the Combined Nomenclature ('CN') classification of an adapter containing a memory chip.

In July 2005, *Data I/O* applied to the Bundesfinanzdirektion Südost for the issue of a binding tariff information in respect of an 'adapter for programming equipment PA T009' to be imported from the United States. It is apparent that electronic memory and logic components are programmed using the adapter at issue. It establishes a connection between the programming machine and electronic components to be programmed. This allows data transferral from the programming machine to those components, which consist of a variety of forms and electrical contacts and which cannot be directly connected to the programming machine. That adapter consists of a printed circuit equipped with continuous capacitors in the form of a plug-in card, which is fitted with four sockets with built-in contact tabs. It also contains a memory-chip on the adapter card which, by recording work progress, stores the programming process and from which the latter can be retrieved.

The goods were classified by the binding tariff information, delivered on 27 July 2005, under subheading 8536 90 85 of the CN. The action brought by *Data I/O* against that information following the dismissal of its complaint against it, seeking to have those goods classified under heading 8471 of the CN, or alternatively heading 8473 of the CN, was rejected by decision of the Tax Court of Munich. Hearing an appeal on a point of law brought by *Data I/O* against that judgment, the referring court was uncertain whether, under the applicable regulation, the adapter at issue should not rather be classified under heading 8471 of the CN. In those circumstances, the German Federal Tax Court decided to stay the proceedings and to refer the following questions to the CJ for a preliminary ruling:

1. Is Note 5(B) to Chapter 84 of the CN to be so interpreted that it allows an electrical adapter, which is designed to provide the electrical connection between an automatic programming machine and electrical components to be programmed, to be classified under heading 8471 of the CN?
2. If the first question is answered in the negative: is the aforementioned adapter then to be classified under heading 8471 of the CN if it contains a so-called memory-chip, on which the programming process is stored and from which it can be retrieved?

The CJ ruled that the adapter at issue, which performs the functions of the electrical connection between the programming machine and the components to be programmed and of the storage of the programming process, which can be retrieved later, fulfils the condition set out in Note 5(B)(c) to Chapter 84 of the CN and must be classified under heading 8471 thereof as a 'unit' of an automatic data-processing machine, in so far as its main function is to carry out data processing. Where that function is absent, such an adapter must be classified under heading 8473 of the CN as a 'part' or 'accessory' of a machine, as the case may be, if it is either essential to the functioning of that machine or constitutes a part or device designed to adapt a machine for a particular operation or an element to perform a particular service relative to the main function of that machine, which is for the referring court to determine. Where that adapter cannot be classified under either of the abovementioned headings, it must be considered to be an 'electrical apparatus for making connections to or in electrical circuits', and consequently, to fall under heading 8536 of the CN.

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CJ rules on the tariff classification of riding gloves (*Roeckl Sporthandschuhe*)

On 29 April 2010, the CJ rendered its judgment in the *Roeckl Sporthandschuhe* case (C-123/09). The case concerns the CN classification of riding gloves, manufactured from a composite material

made of crocheted fabric and a layer of plastic.

The Tax Court of Munich referred the following question to the Court for a preliminary ruling: 'Must subheading 3926 20 00 of the CN be interpreted as meaning that it covers also textile articles that have been raised on one side and covered with a layer of plastic, but which do not have a function beyond that of mere reinforcement, where the raising serves only to improve the adhesion of the layer of plastic and is no longer discernible to the user once the manufacture of the article has been completed (see also Harmonised System Explanatory Note 56.6 on Chapter 39 of the CN?)'

The CJ ruled that the CN must be interpreted as meaning that riding gloves made up of fabric raised on one side and covered with a layer of plastic, where the support fabric is raised on one side and the raised side is then completely covered with a layer of polyurethane foam, which has an essential function in the use of the gloves as riding gloves, must be classified under subheading 3926 20 00 of the CN.

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CJ rules on the customs debt of seized and confiscated goods (*Dansk Transport og Logistik*)

On 29 April 2010, the CJ rendered its judgment in the *Dansk Transport og Logistik* case (C-230/08). The case concerns the extinction of the customs and tax debt of goods which are seized and simultaneously or subsequently confiscated.

Pursuant to an authorisation from the Danish customs and tax authorities granted under Article 6 of the TIR Convention, *Dansk Transport og Logistik* ('DTL') is entitled to issue TIR carnets and act as the guarantor association in connection with TIR transport operations. The referring court is dealing with three disputes relating to customs and tax debts in connection with the smuggling of cigarettes in the course of TIR operations, for which DTL had issued TIR carnets and acted as guarantor. In two of the cases, the goods were transported to Denmark by sea and, in the third case, by land.

The introduction, by sea, of the goods into EU customs territory was discovered by the local customs and tax authorities on 2 May 2000. Two lorries crossed the Danish border, on board a ferry from Klaipeda, in Lithuania, which at the time of the facts in the main proceedings was not yet a Member State of the European Union. When the ferry docked in Åbenrå, those lorries were inspected by the abovementioned authorities, following which, they found a large quantity of cigarettes hidden in the trailers which were not enumerated in the TIR carnets. In all of the cases in the main proceedings the customs authorities immediately detained the cigarettes, in accordance with the first sentence of Paragraph 83(1) of the Customs law. The cigarettes remained in the possession of those authorities from their seizure to their destruction between November 2004 and March 2005.

By letters sent between December 2001 and August 2002, those authorities sought from the transporters, namely the Lithuanian undertakings whose names the TIR carnets were in, payment of customs duty, excise duty and VAT in respect of the smuggled cigarettes. Since those undertakings did not reply to those letters, the customs and tax authorities decided that DTL, as the association acting as guarantor under the TIR Convention, was required to pay the sum corresponding to its maximum liability under the TIR carnets which it had issued for those transport operations. DTL brought an action against those decisions before the Danish Tax Court, which upheld them. DTL then lodged an appeal against that judgment before the Eastern Regional Court and paid, on a conditional basis, the sum sought in two of the cases in the main proceedings, but did not pay the sum sought in relation to the third case.

The referring court considers that Paragraph 83 of the Customs law does not expressly state whether the customs and tax debt relating to the smuggled goods exists and may be recovered where the goods are detained, seized or destroyed in accordance with that provision. In those circumstances, the Eastern Regional Court decided to refer the case to the CJ for a preliminary ruling.

The CJ ruling can be summarized as follows:

- No import duty, excise and VAT will be due in the case the unlawfully introduced goods are seized and confiscated in the area in which the first customs office is situated at the external border of the Community, and are simultaneously or subsequently destroyed by those authorities.
- If these actions take place after the unlawfully introduced goods have left the area of the first customs office, the duty and taxes will be due.
- The authorities in the Member State situated at the external border of the EU at which the

goods were introduced unlawfully are competent to recover the customs debt and the VAT, even if those goods were then transported to another Member State where they were discovered then seized. The authorities in that latter Member State are competent to recover the excise duty, provided that those goods are held for commercial purposes.

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Preferential treatment of goods originating in Egypt, Tunisia or Morocco

Proposals for Council decisions have been published that have regard to the position to be taken by the European Union within the Association Council created by the Euro-Mediterranean Agreement establishing an association between the European Communities and their Member States, of the one part, and the Arab Republic of Egypt, Tunisia or Morocco of the other part, on the amendment of Article 15 (7) of Protocol 4 to the applicable Agreements concerning the definition of the concept of 'originating products' and methods of administrative cooperation.

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