

RECENT DEVELOPMENTS IN EUROPE

TSG CONFERENCE
WINNIPEG
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EU RULES AGAINST MONEY LAUNDERING AND TERRORIST FINANCE

- NEED TO KNOW FULL STRUCTURE
- NEED TO HAVE COPIES OF PASSPORTS
- NEED TO KNOW WHO UBO IS
- NEED TO CARRY OUT RISK EVALUATION

UK NON-DOMICILED

LOTS OF CONFUSION

£30,000 "FEE" IF RESIDENT FOR 7 OUT OF LAST 9 YEARS

US DOUBLE TAX RELIEF CAN ALLOCATE FEE TO INCOME, BUT CANNOT BE REMITTED UNTIL ALL OTHER INCOME AND GAINS REMITTED.

REMITTANCE: FIRST INCOME, THE GAINS, THEN CAPITAL.

DAYS IN COUNTRY – NOW BASED ON MIDNIGHT PRESENCE

UK – PARTICIPATION EXEMPTION

- PROPOSAL TO EXEMPT FOREIGN DIVIDENDS FOR UK COMPANIES, IRRESPECTIVE OF LEVEL OF SHAREHOLDING
- COUPLED TO NEW DEBT CAP
- GAINS ON SALE OF 10% HOLDING ALREADY EXEMPT BUT SUBJECT TO CONDITIONS (1 YEAR HOLDING, BOTH MUST BE TRADING COMPANIES OR PART OF TRADING GROUP)

UNITED KINGDOM

- VAT REDUCED TO 15%

LUXEMBOURG

FROM 1 JANUARY 2009 DIVIDENDS PAID TO FOREIGN PARENT EXEMPT PROVIDED

- PARENT SUBJECT TO SIMILAR TAX TO LUXEMBOURG IN ITS HOME JURISDICTION
- THERE IS A TAX TREATY WITH THE JURISDICTION
- MINIMUM HOLDING 10% FOR ONE YEAR

LUXEMBOURG

TREATY WITH HONG KONG RATIFIED

SWITZERLAND

HAS RATIFIED HAGUE TRUST CONVENTION

NETHERLANDS

- PROPOSAL TO TAKE GROUP INTEREST RECEIVED AND PAID OUT OF THE TAX NET

PROPOSALS FOR SIMPLIFICATION OF COMPANIES IN

- GERMANY
- NETHERLANDS

INCLUDING ABOLISHING MINIMUM
CAPITAL

GERMANY

NEW INHERITANCE TAX LAW FROM 2009
(OLD ONE UNCONSTITUTIONAL)

NEW LAW MAY ALSO BE
UNCONSTITUTIONAL – THAT WOULD
MEAN NO IHT

FRANCE

INDIVIDUALS IMMIGRATING

- GET 5 YEAR TAX HOLIDAY FROM WEALTH TAX ON ON-FRENCH ASSETS
- 50% TAX REDUCTION ON NON-FRENCH PASSIVE INCOME
- STEP UP POSSIBILITIES

ITALY

- TAX OFFICE MORE AGGRESSIVE (MILAN 30,000 ASSESSMENTS RE PROPERTY TAX)
- LEGISLATION TO ALLOW DEALS TO BE DONE (IF YOU ARE ALREADY IN THE WRONG)

ISRAEL

INDIVIDUALS IMMIGRATING

- 10 YEAR TAX HOLIDAY ON INCOME EARNED ON AMOUNTS OUTSIDE ISRAEL
- INCOME OF A FOREIGN TRUST IS EXEMPT FOR 10 YEARS
- NON ISRAEL SOURCE INCOME, INCLUDING EARNED INCOME, IS TAX FREE FOR 10 YEARS

IMPLEMENTING ECJ DECISIONS

CASES CONCERN:

IMPLEMENTATION OF DIRECTIVE

FOUR FREEDOMS:

LABOUR

GOODS

SERVICES/ESTABLISHMENT

CAPITAL

FREEDOMS USUALLY CONCERN SOME FORM OF DISCRIMINATION

RESULT ON LEGISLATION:

- EU BROUGHT INTO LINE WITH DOMESTIC

OR

- FOREIGNERS BROUGHT INTO LINE WITH DOMESTIC

OR

- DOMESTIC BROUGHT INTO LINE WITH FOREIGNERS

OR

- SOME SORT OF FUDGE

FREEDOMS USUALLY CONCERN SOME FORM OF DISCRIMINATION

EFFECT ON LEGISLATION:

- EU BROUGHT INTO LINE WITH DOMESTIC
OR
- ALL FOREIGNERS BROUGHT INTO LINE WITH DOMESTIC
OR
- DOMESTIC BROUGHT INTO LINE WITH FOREIGNERS
OR
- SOME SORT OF FUDGE

THE COURTS

- ECJ DECISION HAS TO BE IMPLEMENTED BY DOMESTIC COURTS
- DO THEY CANCEL THE OFFENDING PROVISION OR JUST BRING IT INTO LINE WITH ACCEPTABLE SITUATIONS?

THE COURTS

- UK COURTS: CANCEL
- DUTCH COURTS: ADJUST
- GERMANY: IGNORE, FUDGE OR TAX EVERYONE

Compatibility of UK CFC with Freedom of Establishment VODAFONE 2

Cadbury Schweppes

- Under UK CFC rules UK parent companies are subject to tax on profits of foreign subsidiaries where the foreign tax paid is less than 75% of the UK tax had the subsidiaries been resident in the UK. There are a number of exemptions from such a tax charge (i.a acceptable distribution policy, exempt activities, public quotation, excluded countries list and motive test).
- HMRC: Cadbury's Irish subsidiary did not meet any of the exemptions.
- ECJ: UK CFC rules cannot be used to levy UK tax on profits of low taxed companies based in other EU member states, unless it regards wholly artificial arrangements which do not reflect economic reality.
- This should be based on objective factors, in particular in relation to premises, staff and equipment.
- The decision whether there are genuine business activities should be made by the UK courts (decision to be expected in 2009).

VODAFONE 2

- Issue: can the scope of the exemptions contained in the UK CFC rules be interpreted in such a way that the UK CFC rules are compliant with art. 43 EC (freedom of establishment) in view of the Cadbury Schweppes decision?
- High Court (UK): it is impossible to interpret the exemptions (in particular the motive test) of the CFC rules in such a way to make it compatible with the freedom of establishment of art. 43 EC. Only by adding a further condition to the application of the CFC rules would cure the invalidity of the provision which would not otherwise comply with EC law. The CFC legislation must be disapplied so that pending such amending legislation or executive action no tax charge can be imposed on a company such as Vodafone.
- HMRC has indicated it may appeal the decision. An application to refer the case to the ECJ was withdrawn so no further ECJ input.
- Vodafone decision may have implications for the Cadbury Schweppes case.

German CFC rules – *Cadbury Schweppes*

- Before 1 January 2008: The German CFC Act provided for a general inclusion of profits of CFCs in the tax base of the parent company
 - Conditions:
 - German resident entity or person owns more than 50% of the foreign company
 - CFC generates so-called “passive income”
 - CFC’s profits are subject to a low level of taxation, i.e. less than 25%
 - [Since 2008: German corporate tax rate = 15% → Germany itself may under certain conditions meet low-tax-level-condition?]
- However: General inclusion of profits is contrary to European law
 - See ECJ in *Cadbury Schweppes* (12 September 2006, case C-196-04)

German CFC rules – *Cadbury Schweppes*

- German reaction
 - Adjustment of the German CFC Act, effective from 1 January 2008, by introducing a substance clause
- Conditions of the substance clause:
- CFC must be resident in the EU or EEA
 - The Parent company proves that the CFC carries out **genuine economic activities** in its state of residence
 - An administrative assistance treaty must be concluded between Germany and the state of residence

Tax credit – *Manninen*

- Former German Tax Credit System (applicable until 2001):
 - Corporate income tax paid by a corporation resident in Germany was creditable or refundable at the level of the recipient of the dividends.
 - However, this was only possible, if the recipient of the dividends could present a certificate issued by the distribution company.
- Before 29 October 2004: Final and non-appealable tax assessments could be amended, *inter alia*, on presentation of a tax certificate
 - Tax assessments can be amended in the case of an **retroactive incident**
 - Retroactive incident included tax certificates
- ECJ in *Manninen* (7 September 2004, case C-319/02):
 - Tax credit must also be granted in respect of corporate income tax paid by corporations resident in other EU Member States
 - Breach of the principle of free movement of capital

Tax credit – *Manninen*

- Impact on German taxation
 - Even where tax assessments are final and non-appealable, tax credit must be granted
 - Irrespective of whether German taxpayers have invested in domestic or foreign corporations
- German reaction
 - General Fiscal Code: presentation of a tax certificate **does not** constitute a retroactive incident
 - Effective for presentation of certificates as from 29 October 2004
 - **BUT:** Amendment frustrates the implementation of "*Manninen*" re final tax assessments
 - Infringement of principle of effectiveness
 - Contrary to European law?

DEPARTURE TAX: *de Lasteyrie du Saillant*

- Before 2007: The German CFC Act provided for a general taxation of unrealized gains on shares in the case of transfer of residence
- Conditions:
- Taxpayer is a German resident for tax purposes for at least ten years
 - Taxpayer holds at least 1% of the company's shares
- However: Taxing such non-realized gains is contrary to European law
- See ECJ in *de Lasteyrie du Saillant* (11 April 2003, case C-9/02)

DEPARTURE TAX: *de Lasteyrie du Saillant*

- The case:
 - Taxation of unrealized gains due to the transfer of tax residence: breach of the principle of freedom of establishment
 - Guarantees necessary for the suspension of payment have a restrictive effect
 - Tax avoidance cannot generally be implied from a transfer of residence
- German reaction
 - Amendment of the CFC Act: EU citizens may benefit from an interest-free suspension until the actual sale of the shares

Withholding tax on minority investments – Denkavit and Amurta

- Situation in Germany
 - Parent Subsidiary Directive only provides for a refund of withholding tax on dividends if the foreign EU parent company holds **at least 10%** of the domestic subsidiary's shares
 - However, for dividends received by German parent companies, withholding tax is creditable or refundable at the level of the parent also with respect to investments < 10%
- ECJ in *Denkavit* (14 December 2006, case C-170/06) and *Amurta* (8 November 2007, case C-379/05):
 - Different treatment of dividends paid to either companies in the same state or companies in another Member State is contrary to European law
 - This holds true in Germany for dividends paid to foreign EU parent companies where the minimum threshold of the Parent Subsidiary Directive (10%) is not reached
- German law on minority investments is discriminatory: breach of the principle of free movement of capital
- German reaction
 - **No adjustment** in German legislation so far
 - Idea: equal treatment by imposing tax on all dividends?

DENKAVIT

ICELAND AMENDED ITS LEGISLATION FOR
EEA COMPANIES

NETHERLANDS STILL NOT EFTA
COMPLIANT (INFRINGEMENT
PROCEDURE ANNOUNCED)

AMURTA

DUTCH RESPONSE

DIVIDENDS TO EEA SHAREHOLDERS
WHICH COULD QUALIFY UNDER PARENT
SUBSIDIARY DIRECTIVE ARE EXEMPT

PROBABLY NOT EU COMPLIANT

DEFINITELY NOT EEA COMPLIANT

BOSAL

COSTS (IN PARTICULAR INTEREST) RE
SUBSIDIARIES OF DUTCH CO DEDUCTIBLE IF
SUBSIDIARY IS (EFFECTIVELY) DUTCH

NOT IN OTHER CASES

COURT HELD PROVISION WAS HINDRANCE TO
ESTABLISHMENT IN OTHER MEMBER STATES

NOTE: EUROPEAN COMMISSION SIDED WITH
NETHERLANDS

DUTCH RESPONSE

ALL INTEREST AND OTHER COSTS (INCLUDING
EXCHANGE DIFFERENCES)
DEDUCTIBLE/TAXABLE (ALSO NON EU)

BUT

COMPLEX PROVISIONS INTRODUCED
RESTRICTING DEDUCTION OF INTEREST
WHERE LOANS TAKEN UP TO INVEST IN
ACQUISITION OF SUBSIDIARY FROM RELATED
PARTY OR INCREASE OF INVESTMENT IN
SUBSIDIARY

BOSAL

NETHERLANDS COURT HELD COSTS RE
INDIRECT HOLDING THROUGH EU
ENTITY IN NON-EU ENTITY ALSO
DEDUCTIBLE

HUGHES DE LASTEYRIE DU SAILLANT (FREEDOM OF ESTABLISHMENT)

EXIT TAX

COURT - CAN TAX ON REALISATION
- MUST GIVE DEFERRAL
WITHOUT CONDITIONS

NETHERLANDS

- SECURITY ON DEPARTURE
DROPPED FOR MOVE TO EU COUNTRY
- NOT EEA COMPLIANT

CONCLUSION

- DIFFERENT COUNTRIES RESPOND IN DIFFERENT WAYS
- EEA APPEARS OFTEN NOT TO EXIST!