

EU Tax News

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affecting business in Europe

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Editorial

Fiscal rules and institutions have an important role in maintaining the sound finances required by the EU's Stability and Growth Pact. For example, there is a trend towards structural reforms that reduce age-related expenditure and thus contribute to the long-term sustainability of public finances.

Meanwhile, the European Court of Justice (ECJ) continues to have a major impact, as demonstrated by the positive outcome for the Italian Government in the IRAP case, reported in this issue. There has been a flurry of decisions in VAT cases, including one with major consequences for the recovery of VAT in Italy, this time to the disadvantage of the government, as reported under the Country Updates for Indirect Tax.

The tax debate also moved to a global stage as the EU has asked Hong Kong and Singapore to consider an information sharing arrangement similar to the Savings Tax agreements with, for example, Switzerland. It is clear proof that not only businesses but also governments are increasingly feeling the impact of globalisation, and have to consider its consequences.

Matthias Roche

Major Developments

ECJ Ruling in IRAP Case

On 3 October 2006, the European Court of Justice gave its decision on the Banca di Popolare di Cremona case (C-475/03), the so-called IRAP case.

The ECJ has ruled Italy was entitled to levy the regional tax on production (IRAP), because it was different from value added tax (VAT) and hence compatible with the Sixth VAT Directive, and in particular with the Article 33(1) provision prohibiting Member States from introducing or maintaining a turnover-based tax other than VAT. IRAP raises over €30bn a year, or more than 2% of Gross Domestic Product (GDP), in revenues for the government, which is expected to record a budget deficit this year of 4.8% of GDP. If the Court had ruled against the tax, the Italian Government would have had to abolish it and might have had to reimburse companies that had paid it, putting even more strain on its budget deficit.

The ECJ decision on IRAP is surprising because it deviated partially from the advice of its own Advocate General. IRAP was introduced by the centre-left

government that ruled Italy between 1996 and 2001, and it has been unpopular with private companies required to pay it whether or not they make profits.

The decision may have relevance for a preliminary ruling pending before the ECJ aimed at deciding whether the Hungarian local business tax, HIPA, is compliant with EU law. However, the HIPA ruling may have a different outcome. The ECJ rejected the notion that IRAP was a turnover tax partly on the basis of certain characteristics in calculating the tax (e.g., inventory fluctuations and determination of the tax base) that do not apply in the case of HIPA.

State Aid: France

The European Commission has referred France to the ECJ for failure to recover illegal State aid.

The Commission has finally decided to take France to the ECJ for failing to comply with its decision of 16 December 2003, indicating that aid awarded by France in the form of tax exemption for certain companies which have taken over the activities of ailing businesses (under Article 44 *septièmes* of the General Tax Code) was incompatible with the State aid rules laid down in the EC Treaty and should be recovered from the recipients. After nearly three years, France has still not taken measures to recover the aid, as required by the 2003 decision.

Asian Tax Havens and the Savings Directive

In its efforts to combat tax evasion, the EU wants to extend information-sharing arrangements to Asian economies.

The success of the 2005 Savings Directive in combating tax evasion has been limited, partly because capital has been fleeing to Asian tax havens, such as Hong Kong and Singapore. Both territories have now indicated it is unlikely that they will co-operate with EU information-sharing requests. Hong Kong was the first to show a lack of enthusiasm by arguing that the territory was legally and constitutionally constrained in its ability to share information with other tax authorities, including China.

At the heart of the debate are three conflicting objectives: the right of states to tax residents' income; the free movement of capital; and national sovereignty. In asking the Asian economies to co-operate in the fight against tax evasion, the EU was making a justifiable request. But the Asian territories' negative response is also far from surprising.

Tax Barriers to Efficient Clearing and Settlement in the EU

The Fiscal Compliance Experts' Group (FISCO) was created in March 2005 to give advice to the European Commission on the removal of fiscal compliance barriers to the clearing and settlement of EU cross-border securities transactions. FISCO's fact finding report was issued in April 2006.

Introduction

FISCO is composed of 15 experts, mainly from private bodies and academia. The Commission will use FISCO's findings as a basis for discussion with Member States in line with its established policy of prior consultation on tax issues. FISCO concentrated on the tax obstacles (Barriers 11 and 12) identified in an earlier report on clearing and settlement (the Giovannini report). The notion "barrier" has been defined in this connection as any feature which reduces the efficiency of cross-border clearing and settlement.

Main Conclusions of the FISCO Fact Finding Study

Withholding tax procedures (Barrier 11)

Giovannini Barrier 11 relates to the problem that the rules and procedures that investors and intermediaries must follow to benefit from the reduced rate or an exemption from withholding tax to which they are entitled sometimes serve to disadvantage foreign intermediaries.

This conclusion was based on the following reasoning:

- investors prefer withholding tax relief to be granted at source rather than by way of a refund;
- relief at source can be granted only with the help of an entity that has formal withholding tax responsibilities;
- the majority of EU Member States either restrict such withholding responsibilities to entities established within their own jurisdiction or require foreign withholding agents to appoint a local fiscal representative to carry out their withholding obligations; and
- as a result, foreign intermediaries are required to appoint a local agent or a local representative to be able to offer relief at source, which represents a significant extra cost for foreign intermediaries *vis-à-vis* local providers.

When reviewing Barrier 11, FISCO not only looked into discriminatory issues but also into the question of whether the procedures are properly adapted to the way securities are

ordinarily held and transferred. Differences in tax collection and relief procedures were also examined. With respect to the latter issue, it was soon clear that there are substantial differences between the Member States. Even within countries, the relief procedures differ according to the type of securities and the legal basis for the relief offered (tax treaty or domestic law). These differences constitute an obstacle in their own right, because it is very difficult and costly to keep up with them if you do not use a local agent.

When FISCO looked into the areas that are not properly adapted to the way securities are held and traded in the market, the starting point was that tax collection and relief procedures should function in an equally efficient way, irrespective of the business model chosen by investors for cross-border settlement and holding of securities. Here again, important obstacles were identified. It was found that procedural tax rules often prevent foreign intermediaries from obtaining direct access to the local Central Securities Depository (CSD), or at least do not allow them to obtain access under conditions similar to those applicable to local intermediaries.

Transaction tax procedures (Barrier 12)

Barrier 12 relates to securities transfer taxes that are collected through a local CSD and that force foreign providers to use that CSD to avoid a less beneficial treatment. It turns out, in fact, that many EU countries have a sort of reverse discrimination rule which encourages the use of foreign intermediaries over local intermediaries. This is the case in Belgium, for example, where the tax is only due when a Belgian intermediary is used to effect the transaction.

The most interesting case is that of the UK, where stamp duty reserve tax (SDRT) is collected through CREST, the CSD for the UK market and Irish equities. This tax is collected from the transferee at the basic 0.5% rate upon each chargeable transfer. When the securities are transferred into a foreign CSD, however, a “clearing charge” of 1.5% becomes due, whilst subsequent transfers occurring in the books of that foreign CSD are no longer chargeable to SDRT.

A foreign CSD can avoid the clearing service charge of 1.5% – by entering into a clearing system agreement with HM Revenue & Customs – but must appoint a UK fiscal representative. This involves extra costs and may put foreign settlement service providers at a competitive disadvantage in comparison with local providers.

FISCO Report on Solutions

FISCO is currently preparing a second report, due in early 2007, that will outline a number of potential solutions to the problems identified in the fact finding report. Some Member States are expected to remove the barriers spontaneously, with a view to making locally-issued securities more attractive for foreign investors. Others will probably want to keep their own procedures and practices, irrespective of the impact they have on cross-border investments. They may associate change with losses of taxing rights and tax revenues. Such Member States will need some encouragement to make the desired changes.

Some of the obstacles identified not only lead to inefficiencies but arguably also constitute unjustified restrictions to the fundamental freedoms laid down in the EC Treaty.

It is relevant that Article 34 of the Markets in Financial Instruments Directive (MiFID) introduces the right of investment firms to obtain non-discriminatory direct access to foreign clearing and settlement systems, without having to maintain a local presence or having to use a local agent for this purpose.

Apart from the steps that may have to be taken to remove discriminatory provisions in the area of withholding tax relief procedures, it is also essential that efforts are stepped up for further harmonisation of withholding procedures. This could be done through the introduction of a common rate of withholding tax or even abolition of withholding tax. The latter would probably only be acceptable for most Member States if exchange of information arrangements were to be intensified. Bearing in mind the slow speed at which progress was made on this issue in connection with the introduction of the EU Savings Directive, this does not seem to be a realistic option in the short run.

A less drastic solution would be to introduce EU-wide tax relief model procedures, perhaps along the lines of that proposed by the so-called Group of Thirty. Such procedures could, for example, provide for relief at source handled by the last intermediary, uniform documentation requirements and deadlines, etc.

This summary was provided by Koen Marsoul (koen.marsoul@be.ey.com) of Ernst & Young Tax Consultants in Brussels, who is a member of FISCO. Requests for copies of the FISCO fact finding report can be emailed to Koen at the above address. ■

Direct Tax

Country Updates

A summary of direct tax developments, provided by local specialists in our European Tax Competency Group.

BELGIUM

Tax Treatment of Foreign Pension Funds

Under Belgian domestic law, contributions to pension and life insurance schemes by employers and individuals are only tax deductible if paid to insurance institutions or welfare funds established in Belgium. Moreover, Belgian tax law provides that the payment of capital or surrender values built up by means of employers' contributions or personal contributions to a taxpayer who has previously transferred his residence abroad is deemed to have taken place on the day preceding the transfer. Finally, Belgian tax law stipulates that the transfer of such capital or surrender values to the pension fund of an insurance institution abroad is taxable.

In the *European Commission v Belgium* case (C-522/04), the Commission claimed that, by implementing these rules, Belgium has infringed EC law on the freedom of movement for services, capital and people. On 3 October 2006, Advocate General Mazák gave his opinion in favour of the European Commission. In his view, Belgian domestic law violates the freedom of services, the freedom of workers and the freedom of capital as laid down in Articles 39, 43, 49 and 56 EC Treaty, inasmuch as the Belgian rules dissuade taxpayers from concluding contracts with foreign operators and from transferring capital or surrender values to foreign operators. The rules also put at a disadvantage employees who wish to transfer their residence or contribute to a foreign operator.

CYPRUS

Establishing a Societas Europaea (SE) in Cyprus

Although EU Council Regulation No. 2157/2001 on the statute for a European company does not provide a tax code, the SE is supposed to be a tax neutral vehicle and should neither be privileged nor disadvantaged in comparison with other Member States' public limited companies. However, Cyprus has a tax regime that allows companies and businesses to carry out trading and investment activities on a European wide scale in a tax efficient way. Key features include a 10%

rate of taxation on income, coupled with a broad participation exemption and the absence of withholding taxes on outbound payments made by Cypriot taxpayers. The Cyprus Government hopes that flexible implementation of the Parent-Subsidiary Directive and the Merger Directive should also help Cyprus to strengthen its advantages as a location for holding companies in general and SEs in particular.

DENMARK

New Proposals on Controlled Foreign Companies (CFCs)

The ECJ's judgment in *Cadbury Schweppes* (C-196/04), regarding the UK CFC rules, has given rise to some debate in Denmark as to whether or not the Danish CFC legislation complies with the freedom of establishment provisions in the EC Treaty. As current Danish CFC legislation is based on objective criteria only, with no possibility of excluding from its ambit arrangements that are not considered wholly artificial, the general consensus is that the Danish CFC rules do not comply with the EC Treaty as interpreted by the ECJ in the *Cadbury Schweppes* case. The Danish Minister of Taxation has acknowledged this, and has announced that he will put forward a bill later this year to amend the Danish legislation. It is not yet known how the new rules will differ from the existing ones or the extent to which it will be possible for taxpayers affected by existing CFC rules to reopen tax returns.

FINLAND

Group Contributions – ECJ Case

In her opinion of 12 September 2006 in the *Oy AA* case (C-231/05), Advocate General Kokott stated that, although the Finnish group contribution regime constitutes a restriction of the freedom of establishment, it can be justified and is, therefore, in compliance with the EC Treaty. The case concerns a Finnish resident company Oy AA, which was planning to grant a group contribution to its ultimate parent company E Ltd., resident in the United Kingdom. According to Finnish law, such contributions are tax-deductible for the contributor and taxable income for the recipient, provided that the transaction takes place between domestic companies and certain other criteria are met. The Supreme Administrative Court had asked the ECJ whether or not Articles 43 and 56, in conjunction with Article 58 of the EC Treaty and the Parent-Subsidiary Directive, are to be interpreted as precluding a system such as the Finnish group contribution regime that requires both the contributor and the recipient companies to

be resident in Finland. The Advocate General concluded that freedom of establishment is the principle most closely related to the case and that the Parent-Subsidiary Directive is not relevant. Accordingly, she stated that the conditions set out in the Finnish Act on Group Contribution constitute a restriction of freedom of establishment, as they place multinational groups in a less favourable position compared with purely domestic groups.

However, she found the restriction permissible as it pursued the legitimate objective of preserving the allocation of taxing powers between the Member States, preventing double relief, and countering tax avoidance. Advocate General Kokott concluded that the conditions prescribed in the Act on Group Contribution were proportionate considering the principle of territoriality. Her opinion, if followed by the ECJ, would mean that there is no immediate need to amend the Finnish rules in relation to group contributions. The date of the ECJ's final judgment has not yet been set.

Group Contributions – Advance Ruling

On 20 October 2006, the Central Board of Taxation (CBT) of Finland delivered an advance ruling on a case similar to the *Oy AA* case, concerning a group contribution granted by a Finnish company (A Oy) to a company (B Ltd.) resident in the UK. B Ltd. had capital losses from previous years that were deductible, under British legislation, only from capital gains. There were plans to place B Ltd. into liquidation and the company was unable to set off its losses carried forward. The CBT held that the group contribution granted by A Oy to B Ltd. was not given for the business activities of B Ltd. to be conducted in Finland as prescribed by Section 2 of the Finnish Act on Group Contribution. Therefore, the contribution was not a tax-deductible expense for A Oy. The CBT seems to be adopting a much stricter interpretation of European law than its Swedish counterparts (see Sweden).

FRANCE

Exit Tax

Applying the solution of the ECJ in *Lasteyrie du Saillant* (C-9/02), the French Administrative Supreme Court has cancelled several administrative guidelines, which organised an exit tax mechanism for French regulated stock-savings plans. Pursuant to administrative guidelines 5 I-1-93, 5 I-2-97, 5 I-7-97, 5 I-9-98 and 5 I-2-04, the transfer of domicile abroad by a person who holds a French regulated stock-savings plan

(*plan d'épargne en actions*) for more than five years triggers the immediate closing of the plan and the unrealised capital gains are thus subject to several tax charges. By contrast, a person who does not transfer his domicile abroad would only have to pay these tax charges when he effectively withdraws cash or securities from the plan.

Stating that Article 43 of the EC Treaty prohibits Member States from implementing exit tax mechanisms, the Court decided that this difference in treatment constituted an obstacle to the freedom of establishment and the administrative guidelines must, therefore, be cancelled. The retroactive effect of this cancellation allows claims for the refund of taxes paid under the regulations. Pursuant to Article L 190 of the French Book of Fiscal Procedures, the taxes that may be claimed for refund should be limited to those paid on or after 1 January 2003.

GERMANY

ECJ: Losses of a Foreign Permanent Establishment (PE)

The German Federal Tax Court (*Bundesfinanzhof*) has referred to the ECJ two cases on the deductibility of losses of a foreign permanent establishment at the level of the German parent company. In the first case concerning *M+T* (C-414/06), the PE was situated in Luxembourg, i.e., in the European Union, whereas in the second case, *Stahlwerk Ergste Westig* (C-415/06), the PE was situated in the US, i.e., in a third country. The deduction of the foreign losses was rejected by the tax authorities who argued that the exemption method in the respective double tax treaties applied not only to positive but also to negative income. Because not all possibilities for loss relief in the other state had been exhausted, the Federal Tax Court referred the cases to the ECJ, basically asking whether the principles established in the *Marks & Spencer* case (C-446/06) applied also to permanent establishments. In the intra-EU case, the freedom of establishment is mainly at stake, whereas in the third country case, the ECJ will – if it decides the first case in favour of the taxpayer – have to deal with the differences arising in a third country situation on the basis of the freedom of capital movement.

ECJ: Tax Exemption for Foreign Charities

In the *Stauffer* case (C-386/04), the ECJ decided that non-resident charitable foundations must be granted the same right for tax exemption with regard to rental income in Germany as is granted to charitable foundations with unlimited tax

liability. The claimant, the Centro di Musicologia Walter Stauffer, an Italian charitable foundation, received income from the renting of real estate in Germany. Although the charity used the income for charitable purposes, the income was subjected to taxation in Germany. Under German law, charities resident in Germany are generally tax exempt, whereas charities subject to limited tax are explicitly excluded from the exemption. The Court did not exclude non-profit organisations from the freedom of establishment principle. However, in the case at hand, the ECJ only applied the freedom of capital movement. The prerequisite that the unequal treatment only constitutes a restriction, if a domestic foundation and the foreign foundation are in a comparable situation, is fulfilled if the foreign foundation is recognised as a charitable entity according to the host state.

ECJ: Temporal Limitation of ECJ Judgments

Advocate General Stix-Hackl recently delivered a second opinion in the *Meilicke* case (C 292/04). In substance, the case concerns the former German imputation system, which allows the taxpayer to set off the corporation tax payable by fully-taxable corporations or associations, determined as a percentage of the dividends received, against their income tax, while denying this credit if the distributing company was established in another Member State. In the first opinion, AG Tizzano held, along the lines of the *Manninen* decision, that such a system was incompatible with EC law.

In her opinion, AG Stix-Hackl focused on the issue of the temporal limitation of a judgment. Such a limitation may only be ordered under circumstances involving the risk of serious economic repercussions and an objective and significant uncertainty regarding the implications of EC law. Member States seeking a temporal limitation must demonstrate and, if necessary, adduce evidence that both conditions are fulfilled. In the present case, the German Government did not provide sufficient evidence with regard to the risk of serious economic repercussions, which cannot be linked to specific amounts but vary with regard to the economic strength of the various Member States. Furthermore, the fact that the European Commission did not pursue its Treaty infringement proceedings did not result in objective legal uncertainty. The Commission did not remain inactive but preferred, by consensus and for the sake of expediency, to wait for the amendment of the national provisions of which it had been notified. Consequently, the AG rejected the German Government's claim for a temporal limitation.

ECJ: Credit Institution Residence and EC Law

In the *Fidium Finanz* case (C-452/04), the ECJ decided that the German rules, which provide that the granting of credit on a commercial basis by a company established in a third country is subject to prior authorisation, which must be refused if the company does not have its central administration or a branch in Germany, are in line with EC law. The ECJ argued that the rules affect primarily the freedom to provide services, a Treaty freedom that third country companies cannot rely on, whereas the restrictive effects of those rules on the free movement of capital were merely an inevitable consequence of the restriction imposed on the provision of services. Therefore, the Court continued, the freedom of capital movement which also applies to third countries was not applicable in the case at hand. Consequently, third country situations have always to be assessed carefully with regard to whether an activity is affected predominantly by the respective national rule or merely as an inevitable consequence.

GREECE

Tax Discrimination of Inbound Dividends

On 17 October 2006, the Commission initiated infringement proceedings, in the form of a reasoned opinion under Article 226 of the EC Treaty, against Greece, requesting it to end the discriminatory taxation of dividends paid from EU companies (inbound dividends) to Greek individual shareholders. If Greece does not reply in a satisfactory manner to the reasoned opinion within two months, the Commission may refer the matter to the European Court of Justice. In the Greek tax system, dividends paid by Greek companies to individual shareholders are exempt from income taxation in order to avoid double taxation of company profits. By contrast, dividends distributed by foreign companies and received by Greek individuals are subject to income tax, with credit for any tax withheld by the foreign company at the time of distribution.

According to the Commission, the above difference in the tax treatment of inbound dividends constitutes a restriction on the free movement of capital, a freedom laid down in Article 56 of the EC Treaty and ruled upon by the ECJ in the *Verkoijen* case (C-35/98). If the individual shareholder controls the foreign company, the difference in the tax treatment of inbound dividends constitutes a restriction on the freedom of establishment, guaranteed by Article 43 of the EC Treaty.

The infringement proceedings against Greece follow those against Belgium, which were initiated in July 2006 for the same reason (discriminatory taxation of inbound dividends). They show the Commission's intention to end the discrimination in the taxation of dividends paid by companies of other Member States within the internal market. It will be interesting to see the reaction of the Greek Government, bearing in mind that the same difference in tax treatment occurs with regard to inbound dividends received by Greek companies.

HUNGARY

Hungarian Motor Vehicle Registration Duty

Under Act No. CX of 2003 on Motor Vehicle Registration Duty, effective from 1 May 2004 (i.e., from Hungary's accession to the EU), registration duty was levied on private motor vehicles or motor caravans when they were registered and placed in circulation in Hungary. The duty was based on emission norms, the type of fuel used and the size of the engine, and there was no difference in the amount of the duty for a new or a used vehicle.

Two cases, *Nádasdi v VPOP* (C-290/05) and *Németh v VPOP* (C-333/05), were referred to the ECJ by the Hungarian courts. The ECJ ruled that the Hungarian registration duty infringes Article 90 of the EC Treaty on the free movement of goods, since the neutrality of internal taxation was not ensured. According to the ECJ, the fact that depreciation of used cars imported from another Member State was not taken into account in the calculation of the registration duty resulted in higher taxation of used cars imported from another Member State compared to that of similar domestic vehicles. The ECJ did not apply a temporal limitation in this case and decided that the excess duty charged on used cars imported from other Member States has to be reimbursed.

The Act on Registration Tax was amended, effective from 1 January 2006, to take into account the age of the vehicle. The ECJ did not rule on the amended law; however, it should be noted that there is an ongoing infringement procedure by the European Commission against the amended law.

IRELAND

Tax Treatment of Foreign Charities

On 17 October 2006, the European Commission announced that it had formally requested Ireland and Poland to end

their discrimination against foreign charities. Under the Irish tax code, donations to charities attract tax relief only if the charities are established in Ireland. In the Commission's view, the omission from this relief of charities established in other Member States is contrary to the EC Treaty. The request is in the form of a 'reasoned opinion' under Article 226 of the EC Treaty. It should come as no surprise, given that earlier this year a challenge was initiated by the Commission against similar UK rules. The Commission has indicated that the ECJ decision in the *Stauffer* case (C-386/04) supports the reasoned opinion issued to Ireland in connection with the tax relief for charitable donations.

Whether or not the Irish authorities concede that the Irish rules for donations to charities breach the EC Treaty remains to be seen. In the event that a contrary view is taken by the Irish authorities, the matter could yet be referred to the ECJ. Nevertheless, it is expected that some account of the *Stauffer* decision will need to be taken in preparing the 2007 Finance Bill.

LITHUANIA

Changes in Capital Gains Taxation

In November 2006, the Lithuanian Parliament approved a law partly amending the Lithuanian law on profit tax. As a result, capital gains on the sale of shares of a subsidiary company, registered in the European Economic Area (EEA) or another tax treaty country, will not be subject to profit tax from 1 January 2007, provided that the shares have been held for at least two years and the holding represents at least 25% of the company throughout that period. Losses from the disposal of such shares cannot be carried forward, but can be used to offset gains from the disposal of such shares within one year.

NETHERLANDS

Breda Lower Court: Income Tax Assessment and Pensions

The Breda Lower Court case of 23 August 2006 (published on 20 October 2006) concerned a former government official who transferred his place of residence from the Netherlands to Belgium in 2001. Upon migration, the (governmental) pension rights built up in the Netherlands were deemed to be realised and thus taxable for Dutch personal income tax purposes. A tax assessment was subsequently imposed by the Dutch tax authorities. However, in accordance with Dutch tax rules, the collection of the income tax due was deferred for ten years

without the requirement to provide security to the Dutch tax authorities. The taxpayer argued, among other things, that the income tax assessment upon migration was not in line with EC Treaty freedoms. This argument was denied by the Lower Court. Referring to the ECJ case *Hughes de Lasteyrie du Saillant* (C-9/02), the Lower Court considered that the income tax assessment imposed upon migration constituted a justified infringement of Article 18 EC Treaty, because effectively no income tax was due, because of the 'automatic' deferral of collection, with the possibility that payment of tax could be excused after ten years. The fact that the said deferral was only granted upon written request did not alter this conclusion.

Another Bosal Third-country Equivalent Case

On 29 September 2006, the Dutch Advocate General delivered his opinion in another Bosal third-country equivalent case. This case concerns a Dutch company, which indirectly holds, by means of EU intermediate companies, a number of third country participations. The Dutch company has incurred costs, which indirectly relate to profits which are taxable in the third countries where the indirect participations are established. As a result, the Dutch tax authorities denied the deduction. The taxpayer, however, held that the costs (also) relate to profits, which are taxable in the EU Member States where the intermediate companies are established. As a result, the deduction of these costs should, based on the ECJ's decision in *Bosal*, not be denied.

The Lower Court of Amsterdam agreed with the taxpayer. The Advocate General, by contrast, suggests that the taxpayer's claim should be rejected, since deduction would also have been denied, if the intermediate companies were established in the Netherlands. Hence, according to the Advocate General, there is no discrimination. It is to be anticipated that the Dutch Supreme Court will follow this reasoning.

Changes in Car Registration Tax System

Further to the *Van de Coevering* case (C-242/05), the Netherlands has proposed a fundamental change in its car registration tax system. In the *Van de Coevering* case, the ECJ ruled that the Netherlands is not allowed – without assessing whether a car is used permanently or temporarily in the Netherlands – to levy a registration tax which is not in proportion to the use of the car in the Netherlands. The Dutch registration tax had always been a tax that depended on the actual registration of the car in the Netherlands. Upon import of a second-hand car into the Netherlands, a registration tax

was due proportionally. There was no provision for a refund procedure upon export. Under the 2007 Budget, changes in the car registration tax are being proposed. By incorporating a refund procedure, these changes result in a car registration tax that is in proportion to the use of a car in the Netherlands.

However, the refund procedure only applies for cars registered in the Netherlands on or after 16 October 2006. In addition, the refund procedure is only available for cars being registered in other EU or EEA Member States. Since the possibility will be created to export second-hand cars, under certain conditions, free of Dutch car registration tax, it is expected that the proposed changes will have a considerable impact on the Dutch automobile industry.

NORWAY

Refunds of Dividend Withholding Tax from 1994

On 19 October 2006, the Norwegian Supreme Court delivered its judgments in the *Edquist* and *Canica* cases. Both relate to the right of a taxpayer to file a law suit against the Norwegian State claiming compensation for Norwegian withholding tax levied on dividends received by Norwegian shareholders from companies resident in the EU or EEA.

The Supreme Court accepted the arguments presented by Ernst & Young Oslo that the six-month time limitation, pursuant to Norwegian domestic tax law, did not apply. The two cases concern taxation on inbound dividends, but the judgments will also apply to withholding tax on outbound dividends (i.e., if Norway levied dividend withholding tax on distributions to EU/EEA resident shareholders in the years 1994-2004). In the *Fokus Bank* case, such taxation was found to be in violation of the non-discrimination principles of the EEA, Article 40 (EFTA Court E-1/04). However, in Norway this was not accepted by the government until 27 January 2006, when the Norwegian authorities decided to withdraw the case that was pending before the Supreme Court.

On 6 March 2006, the Norwegian Ministry of Finance issued guidelines regarding a refund of dividend taxes. In order to obtain a refund of Norwegian withholding tax for the years 2003 and subsequent years, it was stated that the taxpayer (shareholder) was required to file a claim with the tax office before 31 December 2006. The Ministry did not accept claims for refunds of taxes levied prior to 2003. Therefore, the only way corporate or individual EU/EEA resident taxpayers can now

obtain refunds of unjust Norwegian dividend withholding taxes paid in the period 1994 to 2003 is to file a writ of summons before a Norwegian civil court.

POLAND

Taxation of Lotteries

The European Commission has sent Poland a formal request to end discriminatory taxation of foreign lotteries. Winnings from lotteries in other Member States are subject in Poland to higher taxation than winnings in Polish lotteries. The Commission considers this discrimination is contrary to the EC Treaty. The request is in the form of a ‘reasoned opinion’ under Article 226 of the EC Treaty. If Poland does not reply satisfactorily within two months, the Commission may refer the matter to the ECJ.

Poland exempts winnings from domestic lotteries or subjects them to a flat rate tax of 10%, whereas winnings from lotteries in other Member States are taxed at the progressive income tax rates of 19% to 40%. The higher taxation of winnings from foreign lotteries is a restriction of the freedom to provide services throughout the EU, guaranteed by Article 49 of the EC Treaty. The Commission is of the opinion that there is no justification for this restriction. This position is supported by rulings of the ECJ in two cases: *Schindler* of 24 March 1994 (C-275/92) and *Lindman* of 13 November 2003 (C-42/02).

Tax Treatment of Foreign Charities

The European Commission has sent Poland the same formal request to end discrimination against foreign charities as it delivered to Ireland. (See details in entry for Ireland.)

PORTUGAL

Budget Bill for 2007

The Portuguese Government’s Budget Bill for 2007 was presented to the parliament on 16 October 2006. The main EU-related amendments in the Bill are summarised below.

Outbound dividends under the EU Directive

Reduction to 15% (from 20%) of the minimum holding required to qualify for withholding tax exemption on outbound dividends paid by Portuguese subsidiaries to their EU parent or to an EU-based permanent establishment of another EU head office, provided both entities comply with the conditions set out in the Parent-Subsidiary Directive. Further to the Agreement between the EU and Switzerland, Swiss parent

companies will also qualify for the exemption, but minimum holding will be 25% and the holding period will be two years.

Participation exemption

The anti-abuse clause Article 46(10), introduced in 2005, will be revoked. A new rule is expected to be introduced stating that if the income is not subject to effective taxation, only 50% of the dividends are exempt. A full exemption is still available for dividends received by a pure holding company, the so-called Sociedade Gestora de Participações Sociais (SGPS). The exemption will also be extended, under certain conditions, to profit distributions derived from companies resident in Portuguese-speaking African countries.

EU Merger Directive

Following Council Directive 2005/19/EC of 17 February 2005 amending the Merger Directive, the Budget Bill amends the definitions of “partial demerger” (at least one branch of activity should be left in the transferring company when transferring one or more branches of activity to one or more existing or new companies), “branch of activity” (will no longer include the transfer of shareholdings), and “exchange of shares” (extended to those cases where a company holding a majority of the voting rights of a company acquires a further participation). Further, in case of demerger, as far as shareholders of the demerged company are concerned, the value for tax purposes is to be allocated proportionally between the value of the assets transferred and those maintained by the demerged company.

Capital Gains Exemption in Breach of EC Law

The ECJ gave its decision on 26 October 2006 in the case of *Commission v Portugal* (C-345/05). The European Commission had referred Portugal to the ECJ regarding Portugal’s legislation on the exemption of capital gains derived from the sale of a permanent residence. According to the Personal Income Tax Code, capital gains derived from the sale of immovable property, which the taxpayer or members of his family use as a permanent residence, are exempt from income tax if, *inter alia*, the taxpayer reinvests the sales proceeds in the acquisition of another permanent residence situated in Portugal. The exemption does not apply if the taxpayer acquires a permanent residence in another EU Member State.

According to the Commission, such measures are an impediment for foreign nationals temporarily residing in Portugal, emigrating Portuguese nationals, migrant workers and

any other person who wants to leave Portugal. The Commission, therefore, referred Portugal to the ECJ on the basis of the principle of the free movement of persons under the EC Treaty.

The ECJ held that by maintaining in force fiscal provisions, such as Article 10(5) of the Personal Income Tax Code, making entitlement to exemption from tax on capital gains arising from the transfer of real property, intended for the taxable person's own and permanent residence or for that of a member of his family, subject to the condition that the gains realised should be reinvested in the purchase of real property situated in Portuguese territory, Portugal has failed to fulfil its obligations under Articles 18, 39 and 43 of the EC Treaty, and under Articles 28 and 31 of the EEA Agreement of 2 May 1992.

SPAIN

Capital Gains Tax

The European Commission has opened a second infringement procedure against Spain for not complying with an ECJ judgment on capital gains tax. Under Spanish legislation applicable to shares bought before 31 December 1994, capital gains on shares of companies quoted in the Spanish financial markets benefit from a 25% reduction in the tax rate, whereas the equivalent reduction for shares of companies quoted in financial markets outside Spain is only 14.28%.

By a judgment of 9 December 2004 in the *Commission v Spain* case (C-219/03), the Court decided that Spain had violated the principles of free provision of services (Article 49 EC) and of free movement of capital (Article 56 EC) in applying capital gains tax under more favourable conditions to shares traded on Spanish stock exchanges than for shares traded on the stock exchanges of other Member States.

Spain has not transmitted any information to the Commission on the amendments to its legislation. In its submission to the Court, Spain had argued that the existing legislation (entering into force in 2003), as interpreted by the Tax Administration, already extended the domestic regime applicable to Spanish shares without any difference to those traded on a foreign stock exchange. In the Commission's opinion, the most recent modifications of the Spanish law did not affect the specific provisions which were at stake in the Court procedure and, in any case, an interpretation of those provisions at the administrative level was not enough to guarantee the security of law and to remedy the committed violation.

SWEDEN

Advance Rulings on Deductibility of Group Contributions

On 29 September 2006, the National Board on Advance Rulings rendered two decisions regarding the Swedish group contribution system. In summary, the Board ruled that a group contribution is deductible when given to a subsidiary within the EEA under the assumption that the subsidiary has exhausted the possibilities of utilising the losses. However, based on the *Futura* case (C-250/95), group contributions are not deductible if given to a parent company within the EEA.

Under the Swedish group relief system, so-called group contributions are deductible for the contributor and taxable in the hands of the recipient, provided that both the contributor and the recipient are subject to tax in Sweden and if certain other requirements are met. The main issue raised was whether a deduction is granted in Sweden for a group contribution given to a subsidiary or parent company within the EEA, based on the *Marks & Spencer* judgment (C-446/03).

The Board came to the following conclusions.

- The Swedish rules on group contributions are contrary to EC law where group contributions are given to an EEA subsidiary, if it may be shown that the subsidiary has exhausted the possibilities of utilising the losses. In one of the two advance rulings, the Board found this to be the case with respect to a Dutch subsidiary, which was to be liquidated. With regard to the other subsidiaries, which were dealt with in the same ruling and which are resident in Denmark, Finland, Norway and Germany for tax purposes, the Board reached the conclusion that the applicant had not been able to show that the possibilities of utilising these losses had been exhausted.
- It is irrelevant whether the group contribution is subject to taxation in the recipient country when assessing whether the group contribution is deductible for Swedish tax purposes.
- The deduction is limited to the lowest amount of loss as computed under Swedish tax rules and the tax rules in the recipient country.
- Based on the principle of territoriality laid down in the *Futura* case (C-250/95), the Swedish rules are not contrary to EC law where group contributions are given to a parent company within the EEA. In this respect, it is of interest that three of the seven Board members dissented and took

the view that, in principle, there is no hindrance to giving group contributions to a parent company within the EEA. In this case, however, the three members who dissented were of the opinion that the subsidiary in question had not been able to show that the parent company had exhausted all possibilities of utilising the losses.

The rulings are expected to be appealed to the Supreme Administrative Court. (See also under Finland for related developments in connection with the Finnish group contribution regime.)

Tax Rules on Partial Demergers

In February 2005, the Council of the EU adopted Directive 2005/19/EC amending Directive 40/434/EEC on the common system of taxation applicable to mergers, divisions, transfer of assets, and exchanges of shares concerning companies of different Member States. Under the Directive, the Member States must implement rules on partial demergers no later than 1 January 2007. On 14 September 2006, the Swedish Government submitted an exposure draft regarding partial demergers to the Swedish Council on Legislation, which did not raise any objections to the proposal. According to the budget proposal for 2007, the government intends to submit a bill to the parliament later this year, which would introduce tax rules on partial demergers with effect from 1 January 2007.

SWITZERLAND

Protocol between Switzerland and Spain

On 6 September 2006, the Swiss Federal Council published in its Official Gazette a new agreement, entitled Amending Protocol to the Convention of 26 April 1966, between the Swiss Confederation and Spain for the avoidance of double taxation with respect to taxes on income and capital. The Amending Protocol, signed in Madrid by the competent authorities on 29 June 2006, contains tax exemptions at source with respect to the payment of dividends, interest and royalties, limitation of benefits provisions and an extensive exchange of information clause to be included in the current Swiss-Spanish double tax treaty.

Since its signing 40 years ago, the treaty has never been amended. Moreover, it has been the only tax treaty concluded by Spain that did not contain an exchange of information clause. The first renegotiations of the current treaty started around four years ago. One of the main purposes of the

Amending Protocol is to grant to Swiss companies a similar tax treatment as for companies which are resident in the EU and to facilitate the exchange of information between the respective tax authorities. Both jurisdictions should now ratify the content of this agreement following their respective domestic legal procedures.

UNITED KINGDOM

Deutsche Morgan Grenfell Case

On 25 October 2006, in the *Deutsche Morgan Grenfell* case (2006, UKHL 49), the House of Lords gave its judgment in favour of the taxpayer, reversing the previous decision of the Court of Appeal. The central issue for consideration was whether it was possible for a taxpayer to make a restitutionary claim in consequence of a “mistake of law”, on the basis they had overpaid UK tax by following a UK domestic provision, which was subsequently found to be contrary to the EC Treaty. In this regard the House of Lords agreed, holding that the date from which the six-year statutory time limit should run is the date that the position of UK domestic law becomes clear (which would typically be when the ECJ gives its decision in the relevant test case).

The implications of this decision for claims or potential claims under the different group litigations vary, though in general terms, where the relevant domestic provisions are held by the ECJ to contravene the EC Treaty, its effect should be to extend the statutory time period in which taxpayers are able to make High Court claims against HM Revenue & Customs.

For claims made after 8 September 2003, this position is subject to the potential application of section 320 of the Finance Act 2004, which sought to negate the arguments raised by the taxpayer in this case. However, the compatibility of section 320 with European law is being challenged separately on the basis it did not provide for a transitional regime. If this argument is successful, the statutory time limit may similarly be extended for claims made subsequent to this date. ■

Indirect Tax

Latest EU Developments

ECOFIN: Outcome of 7 November 2006 Meeting

The EU's Economic and Financial Affairs Council (ECOFIN), comprising the economics and finance ministers of the Member States, met in Brussels on 7 November 2006 under the presidency of Finland. A decision on reduced rates of value added tax (VAT) was adopted. Other topics discussed included excise duties on alcoholic beverages, duty-free allowances for travellers and VAT on on-line media services.

Reduced VAT Rates on Labour-intensive Services

The Council adopted a decision authorising certain Member States to continue to apply reduced rates of VAT for certain labour-intensive services until 2010, in accordance with a Directive on reduced VAT rates adopted earlier this year. The decision implements the provisions of Directive 2006/18/EC. It extends an experiment, launched in 1999, to apply reduced VAT rates for labour-intensive services until 31 December 2010 and allows all Member States to take part in the experiment under the same conditions. In accordance with the Directive, Member States may apply a reduced rate to district heating and two (or, in exceptional cases, three) out of the following five services:

- small repair services;
- the renovation of private dwellings;
- window cleaning and private household cleaning;
- domestic care services; and
- hairdressing.

Member States must also have requested authorisation to apply the reduced rate to the affected services by 31 March 2006.

The decision will apply from January 2006 (with retroactive effect) until December 2010. Under Community law, the minimum VAT standard rate is 15% and the minimum VAT reduced rate is 5%.

Minimum Excise Duty Rates on Alcoholic Beverages

The Council examined a compromise proposal, presented by the Finnish presidency, on the adjustment of minimum excise duty rates applied by the Member States on alcoholic beverages, in order to counter the effects of inflation.

The Council agreed to continue work on the dossier with a view to reaching an agreement at its meeting on 28 November 2006, while noting that an automatic solution for future inflation adjustments of the minimum rates would be desirable. The proposed adjustment to Directive 92/84/EEC provides for a 31% increase in the minimum excise duty rates on alcohol, intermediate products and beer, in order to restore their real value to the levels at which they were set when they were introduced on 1 January 1993. The aim is to ensure greater convergence between the rates applied by the Member States in order to prevent distortions of competition and fraud. The principal issues that remain to be resolved concern the inflation adjustment for beer and for certain intermediate products and alcohol.

Duty-free Allowances for Travel from Third Countries

The Council also examined a compromise proposal presented by the presidency on allowance exemptions from VAT and excise duties on goods carried by persons entering the EU from third countries.

Here again, the Council agreed to continue work on the dossier with a view to reaching an agreement at its meeting on 28 November 2006. The proposal is aimed at revising and replacing Directive 69/169/EEC on traveller allowances, whilst adapting it to the enlarged EU, restructuring it and simplifying certain provisions. It provides for an increase in the limit on duty-free allowances, in particular to cater for the effects of inflation since they were last revised in 1994. The principal issue that remains to be resolved concerns the monetary limit on duty-free allowances (currently €175) for persons entering the European Union.

VAT on On-line Media Services

The Council took note of remarks by the French delegation regarding the rate of VAT charged on on-line media services. Whereas current EU rules allow Member States to apply a reduced VAT rate (minimum 5%) to sales of newspapers and periodicals, they require the standard VAT rate (minimum 15%) to be applied to the on-line press. The French delegation considers that the distinction is hindering the development of the on-line press at a time when the industry is adapting to the digital environment. It has requested an amendment of the EU rules, in order to enable Member States that so wish to apply a reduced rate to the on-line press.

Energy Efficiency Proposal

On 19 October 2006, the Commission published details of its Action Plan for Energy Efficiency. One of the ten priority action points is to introduce a more coherent use of indirect taxes as an incentive to improve energy efficiency.

In a move reflecting Europe's growing fears about its energy dependence on the rest of the world, as well as its preference for high environmental standards, Andris Piebalgs, the Energy Commissioner, said that he wanted to put the EU on course for a 20% energy saving by 2020.

Wasteful television standby settings and the energy efficiency of computers and water heaters are to be targeted in this new legislative proposal aimed at cutting €100bn a year from the EU's energy bill, in a move that could impose Europe's green agenda on the world. Stringent new European Commission energy efficiency targets for items such as electrical appliances and cars could set new global standards, since all imports into the European market would have to comply.

A Green Paper on indirect taxation will be issued in 2007. The Energy Tax Directive will be reviewed in 2008 to bring about a more targeted and coherent use of energy taxation by integrating energy efficiency and environmental aspects. The use of tax credits to promote the manufacture and purchase of energy efficient products will also be considered in 2007.

The plans will be backed by a raft of new regulations, including measures aimed at cutting carbon dioxide emissions that would help Europe meet its obligations under the Kyoto treaty. New energy standards for buildings would also be set. From next year the Commission wants to implement directives setting down minimum energy performance requirements for 14 priority products, including boilers, computers, washing machines, office lighting and air conditioning. Commissioner Piebalgs says "special attention will be devoted to standby loss reduction" – a reference to the power-consuming standby modes on televisions and other appliances.

Mr Piebalgs proposes tougher rules on energy efficiency labelling, and said that the additional investment spent on achieving greater energy efficiency will be "more than compensated" by annual savings. The paper will also propose new minimum energy performances for new and renovated buildings and legislation next year, if necessary, to achieve the desired cuts in carbon dioxide emissions from cars by 2012.

His plans need to be approved by Member States before becoming law. The proposed regulations – including extensions of existing rules – would impose European energy efficiency standards on any company worldwide seeking access to the EU's 480 million consumers.

The political will to control carbon emissions appears to be gathering strength. The Stern Review, published by the UK Treasury on 30 October 2006, warned that the economic damage from climate change could amount to 20% of global GDP. To avoid this costly outcome, the report said world emissions of carbon would have to fall by at least 25% from current levels by 2050, and perhaps much more.

Proposed Consolidation of Mutual Assistance Directive

On 19 October 2006, the Commission published a proposal for a Council directive on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures (codified version) (COM[2006]605).

The background to this proposal is an agreement concluded in 1992 aimed at ensuring that Community law is clear and transparent. Under the agreement, if a piece of legislation has been subject to a number of amendments that require cross-referencing to the amending legislation (and certainly where there have been ten such amendments), it should be put into consolidated form or "codified" as the Commission puts it. There is a fast-track process for agreement of codified legislation, on the understanding that it does not involve any change to the substance of the legislation.

The original Directive on mutual assistance between Member States was enacted in March 1976 and now covers, *inter alia*, VAT, insurance premium taxes, import and export duties and excise duties. This proposal is for a codified new version and the repeal of amending legislation enacted since 1976.

Codification of Exemption for Small Consignments

The Council has agreed Directive 2006/79/EC of 5 October 2006 covering tax exemption for imports from third countries of small consignments of goods of a non-commercial character.

This is a codification of the 1978 Directive, in recognition of the fact that the original version has been substantially amended several times. As indicated above, codification is 'Commission-speak' for consolidation of earlier legislation that has been the subject of a number of amendments. ■

Country Updates

AUSTRIA

VAT: Transport Operators

The ECJ released its judgment in the *Commission v Republic of Austria* case (C-128/05) on 28 September 2006. The infringement proceedings were started against Austrian rules which allow non-established transport operators with a turnover from such supplies in Austria below €22,000 per annum to dispense with VAT registration, declaration, invoicing and accounting obligations. The Austrian authorities claimed that, for businesses below the turnover threshold in Austria, the output tax to be collected would be equal to the input tax eligible for deduction. There would, therefore, be no point in including such businesses in the VAT system.

The defence put forward by the Austrian Government relied solely on the Article 24 provision – “Special scheme for small undertakings”. The Court follows the opinion of Advocate General Sharpston in rejecting this defence, on the grounds that the Austrian rules apply to a wider population of taxable persons than “small undertakings” envisaged by Article 24 and the Austrian rules, which give a complete exemption from the requirements of registration, declaration, invoicing and accounting, go beyond a simplified procedure envisaged by Article 24. Accordingly, Austria has failed to fulfil its obligations under Articles 22 (issue of invoices, submission of periodic returns and payment of tax) and Article 18 (holding of invoices to support input deduction).

GERMANY

VAT: Tax Base for Private Use

In the *Hausgemeinschaft Jörg und Stephanie Wollny* case (C-72/05), the ECJ confirmed on 14 September 2006 that the tax base for private use, according to Article 11(A)(1)(c) of the Sixth VAT Directive, can be calculated as a portion of the acquisition or construction costs of a building, established in accordance with the length of the period for adjustment of deductions for VAT, as provided for in Article 20 of that Directive (i.e., the capital goods scheme). That taxable amount must include the costs of acquiring land on which the building is constructed, when that acquisition has been subject to VAT and the taxable person has deducted that tax.

The case concerns a building constructed by the Wollny

household and treated in its entirety as an asset of the business, with full input tax deduction. However, about 20.33% of the building was privately used. The dispute concerns the basis of calculation for the taxable supply of private use, in particular the meaning of the term “full cost” in Article 11(A)(1)(c) in these circumstances. As well as the question of which items of expenditure constitute the full cost, the case also considers whether a Member State can insist that the total cost is spread across a period of years corresponding to the Article 20 annual adjustment period, in order to prevent the potential for untaxed use after that period has ended.

Based on this decision, the German VAT law, which provides for a tax base of 1/10th of the building costs for the deemed self-supply as of 1 July 2004, is in line with the Sixth VAT Directive. Prior to 1 July 2004, the tax administration will also use the 1/10th rule where the taxable person, referring to the ECJ’s *Seeling* case (C-269/00), has deducted the full input VAT. Where the taxable person did not refer to *Seeling*, the tax base will be calculated according to the depreciation rules, as laid out in the corporate/income tax regulations which, for buildings, indicates a proportion of 1/50th.

Finally, it is important to note that the German tax authorities treat the deemed self-supply of the whole building after *Seeling* as a taxable transaction for which 16% (from 1 January 2007 19%) VAT is due, while the sale of the building is VAT exempt, with the right to opt for taxation. However, it is questionable whether this approach (taxable self-supply) is in line with the Sixth VAT Directive.

ITALY

Recovery of Italian Vat Paid on Motor Vehicles

On 14 September 2006, the ECJ released its judgment in case of *Stradasfalti Srl v Agenzia delle Entrate Ufficio di Trento* (C-228/05). This judgment may give rise to a significant retrospective claim opportunity for any businesses that have incurred Italian VAT on the purchase of cars and related expenditure.

The appellant, a road builder, purchased private cars for employees to use for travel for work purposes and for private purposes as a fringe benefit. In the years 2000 to 2004, the appellant refrained from deducting any input tax on the purchase of these cars and on the purchase of fuel for them, in accordance with Italian law. However, in 2004 the

appellant decided to challenge the validity of the input tax restriction and lodged a retrospective claim for input tax on this expenditure covering the period 2000 to 2004. The tax authorities refused this claim and the dispute escalated into a referral to the ECJ by the First Instance Tax Court.

The essential problem was that the Italian law, which blocks input tax deduction on the purchase of cars “not intended for public use and not intrinsic to the taxable person’s business activity” and on fuel for use in cars where the input tax deduction is blocked, was introduced in its particular form with effect from 1 April 1979. This means that it cannot be justified under Article 17(6) as a measure in force when the Sixth VAT Directive came into force (i.e., on 1 January 1979 in the case of Italy). The Commission stated that the measure has been amended since its introduction – a 50% deduction being allowed in some circumstances up to 1983 and a percentage deduction being allowed since 2001 on leased cars and cars not powered by internal combustion. The Commission also stated that the measure, originally intended to run until 31 December 1983, had been extended on 24 occasions.

The Italian Government was, therefore, forced into seeking to defend the validity of the legislation by reference to Article 17(7). In a detailed judgment, the ECJ ruled that, insofar as an exception from the system of deductions has not been established in accordance with Article 17(7) of the Sixth VAT Directive, the national tax authorities may not rely on a provision derogating from the principle of a taxable person’s right to deduct VAT, as set out in Article 17(1) of that Directive.

The judgment makes the levy tax deductible, presumably for the past four years. On 15 September 2006, the Italian Government enacted a legislative decree regulating the effects of the ECJ judgment for Italian taxpayers. According to the decree, in order to recover Italian VAT paid on motor vehicles (and related services such as maintenance, etc.) up to 13 September 2006, Italian taxpayers must file an application form before 15 December 2006. The purpose of the decree seems to be to avoid the recovery of retrospective VAT through offsetting the amount in the yearly VAT return (related to year 2005) which was due to be filed by 31 October 2006. Nevertheless, each taxpayer needs to evaluate, on a case by case basis, how and for which years the refund can be requested as various options and deadlines apply, depending on when the purchases took place.

LITHUANIA

Consignment Stock for Intra-Community Trade

In September 2006, the Lithuanian Government submitted to parliament draft amendments to Lithuanian VAT law regarding the introduction of a consignment stock simplification for intra-Community trade. Under the proposed amendments, foreign suppliers, who transport their goods to Lithuania and place them into a warehouse as consignment stock, can avoid VAT registration in Lithuania provided that:

- ownership of the goods is transferred to a Lithuanian VAT payer within 12 months from delivery;
- the goods are placed into a warehouse or other premises owned or used by the VAT payer; and
- the goods are used solely for the purposes of the economic activities of the VAT payer.

Under the proposed amendments, a delivery that meets these conditions may be considered an intra-community acquisition by the purchaser.

SWEDEN

Place of Supply for Installation of Cross-Border Cable

In September 2006, the ECJ issued the Opinion of Advocate General Leger in the Swedish referral *Aktiebolaget NN v Skatteverket*, which deals with the complex VAT place of supply rules for the cross-border installation of goods. The case relates to the installation of a fibre optic cable that runs from one EU Member State to another, through a country that is outside the European Union.

The Advocate General’s Opinion outlines the following principles:

- if the greater part of the total cost of the supply and installation contract is attributable to the cable, the total supply is a supply of goods for VAT purposes;
- Article 8(1)(a) of the Sixth VAT Directive requires that, in determining the place of supply, the supply must be split in proportion to the geographical position of the cable; and
- this Article is to be further interpreted as meaning that no VAT shall be due for the part of the supply of goods that relates to the territory of a country outside the European Union. ■

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