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Preface

The European Court of Justice has had to deal with more and more cases concerning direct taxation and the fundamental freedoms in the last years. This is also due to the fact that the European Commission seems to be more and more willing to criticize national tax law systems and initiate infringement procedures against EU Member States. As all these cases are of great interest for academics as well as practitioners, they need to be analysed carefully.

From 11 to 13 November 2010, the conference "Recent and Pending Cases at the ECJ on Direct Taxation" took place in Vienna. A great number of experts on European and international tax law accepted our invitation to attend the conference and took part in the discussions. At the conference, cases in the field of direct taxation now pending before or recently decided by the ECJ were presented by experts of the respective countries. The national reporters thereby provided insights in the national as well as the European background of the cases. These presentations were the basis for further lively discussions among the international participants. Possible consequences of these cases, the future ECJ decisions and future trends in the ECJ case law were discussed and analysed in detail. The results of the conference are published in this book.

The conference would not have been possible without the support of the Special Research Programme "International Tax Coordination" and the City of Vienna.

We would like to express our sincere thanks to the authors who contributed to the conference by presenting the cases from their countries at the conference and getting actively involved in the discussions. Furthermore, they supported the entire project and the publication of this book by committing themselves to a strict time schedule.

We are also grateful to the Linde publishing house for the co-operation and the quick realization of the publication of this book. Linde has generously agreed to include this book in its catalogue.

Our particular thanks go to Renée Pestuka for the smooth organization of the conference, to Margaret Nettinga, who edited and polished the texts of the authors, and to Karoline Spies, who supported us in deciding on the structure of the conference and in the preparation and publication of this book.

Michael Lang | *Pasquale Pistone* | *Josef Schuch* | *Claus Staringer* | *Alfred Storck*

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I. *Foggia* (C-126/10): Interpretation of "valid commercial reasons" in the Merger Directive

I.1. Description of the facts and issues

In 2003 three Portuguese holding corporations of a Portuguese bank merged by incorporation into a fourth Portuguese holding corporation (Foggia, SGPS, SA). The corporations involved in the reorganization were all incorporated under the legal form of a holding corporation ("*Sociedade Gestora de Participações Sociais*" or "*SGPS*"), which means that the activities pursued by those companies are limited by definition to the holding of shareholdings in other corporations. The merger by incorporation benefited from the special tax neutrality established under Portuguese tax law and framed on the basis of the EU Merger Directive, where one of the conditions is that the reorganization is based on "valid commercial reasons".

One of the holding corporations incorporated into Foggia also had losses of circa EUR 3.5M that it could carry-forward. Portuguese tax law allows that within a merger by incorporation, losses of the incorporated corporation may be carry-forward and deducted by the incorporating corporation.

Contrary to the application of the special tax neutrality regime for reorganizations where the taxpayer can benefit from it if it complies with the said requirements and declares as such in its accounts and tax returns, the carry-forward of losses by the incorporating company requires a prior authorization by the Ministry of Finance following a special request made by the taxpayer. Portuguese tax law established as requirements for the approval of the carry-forward-of- losses request that: (i) the restructuring is a merger, division, transfer of assets or an exchange of shares, as established in the Portuguese special tax neutrality regime for reorganizations; (ii) the request must be filed with the Ministry of Finance within a certain time limit; (iii) the merger has "valid commercial reasons" such as the "*restructuring or rationalization of the activities of the companies involved*" and it "*fits in with a medium or long term strategy of re-dimensioning and corporate development with positive effects in the producing structure*".

Foggia duly made the request for the transfer of losses and to be granted the right to deduct the carry-forward losses of the incorporated corporation and it provided evidence that the restructuring benefited from the application of the special tax neutrality regime for restructuring. The Ministry of Finance did not contest in its reply to the authorization request the fulfilment of the said two requirements, but rather denied the authorization of the transfer of losses on the basis that the merger was not based on "valid commercial reasons" for the incorporating corporation. The request submitted by Foggia was thus denied by the Ministry of Finance. The basis of this decision was the fact that (i) the incorporated corporation had developed almost no activity as a holding; (ii) it had no financial holdings and its net value was almost irrelevant when compared to that of the incorporating corporation; and (iii) the positive effects of the merger were insignificant from the perspective

of the incorporating corporation (Foggia). From the perspective of the Ministry of Finance, the incorporated corporation was merely transferring the carry-forward losses and hence its inclusion in the merger only served that purpose. Notwithstanding this, the Ministry of Finance conceded that the restructuring in itself (the merger by incorporation of the Portuguese bank's three holding corporations into Foggia) had a positive effect in terms of the overall cost structure of the group (as it would allow a reduction of the administrative and managing costs).

Foggia contested in court that the concept of "valid commercial reasons" was capable of being fulfilled for the purposes of the application of the special tax neutrality regime for reorganizations and not for the purposes of the transfer of losses. The Ministry of Finance replied that the fact that a reorganization was capable of being considered a transaction that benefits from the special tax neutrality regime for reorganizations does not automatically imply that it should be granted authorization for the transfer of losses, as the latter has additional and more stringent requirements.[1] The first instance court, as well as the Central Administrative South Court, did not rule on the interpretation of the "valid commercial reasons" issue, since both invoked a long-standing case law to the effect that matters where the tax authorities are legally granted a "technical discretion" with regard to its powers to approve requests are not capable of a judicial review. However, urged by the taxpayer, the Central Administrative South Court submitted to the ECJ the issue of whether the interpretation of the Ministry of Finance on "valid commercial reasons" solely from the perspective of the incorporating corporation and not that of the group as a whole was in conformity with the concept of "valid commercial reasons" as established in the Merger Directive.[2]

I.2. Analysis of the case

The *Foggia* case deals with a purely domestic reorganization, but since the *Leur-Bloem*[3] case the ECJ has long maintained that it considered itself competent to rule on the merely domestic issues where the case involves the interpretation of a concept of an EU law instrument that might be relevant for cross-border situation and where a uniform interpretation is required across the European Union. The said interpretation was also upheld recently in the *Modehuis*[4] case and both cases dealt precisely with the interpretation of the Merger Directive as in the *Foggia* case.

1 The Ministry of Finance did not maintain that the concept of "valid commercial reasons" itself was capable of being interpreted differently in the context of a transfer of losses request, but merely stated in general that the requirements for such approval were more stringent than that of the application of the special tax neutrality regime for reorganizations.

2 Article 15, no. 1, item a) of Council Directive 2009/133/EC, 19 October 2009.

3 ECJ 17 July 1997, C-28/95, *Leur-Bloem* [1997] ECR I-4161, paras. 16-34.

4 ECJ 20 May 2010, C-352/08, *Modehuis A. Zwijnenburg*, paras. 31-35.

However, one more complex issue is whether the Merger Directive deals with the concept of "valid commercial reasons" concerning the transfer of losses. The Merger Directive has no specific treatment for losses of corporations that are involved in a reorganization transaction as defined by the Merger Directive, but it simply seems to provide that where a Member State allows such a transfer of losses in a domestic reorganization it should also apply those same rules allowing for the transfer of losses in a cross-border reorganization on a non-discriminatory basis.[5] In this respect, one should bear in mind that the requirement in Portuguese tax law that a transfer of losses subject to a reorganization be based on "valid commercial reasons" was introduced by the Portuguese tax legislator upon the implementation of the Merger Directive into Portuguese tax law and aligns the concept of "valid commercial reasons" both for the entitlement to the special tax neutrality regime for reorganizations and for the transfer of losses. One might argue, as the Ministry of Finance did, that there are additional requirements for the transfer of losses to be granted, but that this should not imply that the concept of "valid commercial reasons" itself can be interpreted in a different manner where it concerns tax neutrality and the transfer of losses.

The interpretation of the Ministry of Finance seems to rely almost entirely on the perspective of the incorporating corporation and not of the group. The refusal to allow the transfer of losses seems to be based on the fact that the incorporating corporation would have no "valid commercial reasons" for merging by incorporation with a corporation that has nothing more than losses as its "asset". The fact that the group as a whole might be said to have "valid commercial reasons" for the reorganization seems to be overlooked where the transfer of losses is concerned.

The Ministry of Finance seems to single out the fact that only losses are in fact being incorporated into Foggia as the basis for reaching its conclusion that there are no "valid commercial reasons" and thereby implying that such concepts require a separate analysis of what is in fact being transferred to determine whether the are valid commercial reasons or not. There is no evidence in the case that the incorporated corporation was somehow stripped of any assets prior to the reorganization or that the existing losses were somehow disputed or arose from questionable transactions. However, in the *Leur-Bloem* case[6] the ECJ already ruled on this pattern of issues concerning the substance requirements for the purposes of complying with the "valid commercial reasons" threshold and, absent any abusive practices being found,[7] it seems that the fact that the incorporated corporation's "assets" are merely its losses cannot in itself mean that its merger by incorporation in another corporation has no "valid commercial reasons".

5 Article 6 of Council Directive 2009/133/EC, 19 October 2009.

6 ECJ 17 July 1997, C-28/95, *Leur-Bloem*, paras. 50-51.

7 ECJ 5 July 2007, C-321/05, *Hans Markus Kofoed*, para. 38.

Furthermore, it seems clear that the Merger Directive rationale is one of allowing groups of corporations to reorganize in a tax-neutral framework and not necessarily one of the specific analysis of the participating corporations' motives for entering into a reorganization in an isolated manner. Therefore, the basis of the interpretation of the concept of "valid commercial reasons" as one solely from the perspective of the incorporating corporation does not seem in line with the overall purpose of the Merger Directive to allow corporations to reorganize in a tax-neutral manner.

II. *Secilpar* (C-199/10)

II.1. Facts

Secilpar SL is a company incorporated in Spain, with its head office and place of effective management in the Spanish territory. In December 2000 it acquired shares in the Portuguese company, Cimpor – Cimentos de Portugal SGPS SA, for a total amount of EUR 320,436,410.00[8] and the latter distributed dividends to Secilpar SL in 2003 in the total amount of EUR 9,273,552.00. The dividends were subject to withholding tax under the Corporate Income Tax Code (CIRC) and the Code governing the Municipal Tax on Transfers and the Succession and Donation (CIMSISD). In both cases, the withholding tax fell on the gross amount of the dividends and was a final withholding.

In 2003 the general prohibition on withholding taxes on dividends distributed to parent companies resident in another Member State was applicable (Article 5 (1) of the Directive) to Portugal. However, the dividends distributed to Secilpar did not meet all the conditions in the Parent-Subsidiary Directive, since the holding was less than 25% (Art. 3, (1) a) of the Parent-Subsidiary Directive as applicable to the fiscal year of 2003) and, consequently, the issue did not involve an appreciation of the Portuguese regime in the light of the Directive. Moreover, Articles 182 and 184 of the CIMSISD remained applicable to cases not covered by the same Directive after the *Epson* case:[9] those articles provided for a so-called succession and donation tax (withholding tax of 5%) in respect of transfers, without consideration, of shares in companies (the 'ISD') which was levied when profits were distributed on the dividends paid by companies which had their seat in Portugal to a company not resident in the national territory.

As a result of a claim to the first instance tax court, confirmed by the Administrative Supreme Court, the application of the double taxation convention concluded between Portugal and Spain meant that the rate was reduced to 15%; this

[8] *Acordao do Supremo Tribunal Administrativo*, Case 01/09, 10 March 2010, 2. Secção at: http://www.dgsi.pt/jsta.nsf/35fbbbf22e1bb1e680256f8e003ea931/fdacab23b154f12b802576e7003ffc7e?OpenDocument, in Portuguese.

[9] ECJ 8 June 2000, C-375/98, *Ministério Público, Fazenda Pública and Epson Europe BV.*

was applied to 50% of the dividends and, curiously, the 5% withholding tax under the ISD was also cancelled.

In contrast, if the shareholder were resident in Portugal, as long as the acquisition value was not less than either 10% or EUR 20,000,000.00 (in the case under analysis it amounted to EUR 320,436,410.00) and the holding had been maintained for an uninterrupted period of one year, the dividends would not have been subject to either withholding tax or to subsequent taxation (Articles 46 (1) and 90 (1) c) of the CIRC).

Whereas this different treatment was not considered discriminatory by the first instance court (Tribunal Tributario de Lisboa, proc. 1977/06.8 BELSB, 30 September 2008, Point 3), the second chamber of the Portuguese Administrative Supreme Court asked the ECJ whether the withholding tax on dividends for the year 2003 applicable to a non-resident shareholder breached the principles of non-discrimination, the freedom of establishment and the free movement of capital embodied in the then Articles 12, 43, 46, 56 and 58(3) of the EC Treaty (currently Articles 18, 49, 52, 63, 65 (3) of the TFEU) and Article 5(1) of Directive 90/435/EEC.

II.2. Acte clair

The ECJ will probably decide by reasoned order, since it can reasonably argue that the *Denkavit France* case[10] has already clarified the issue on the discriminatory treatment of outbound dividends.[11] Moreover, in the *Commission v. Spain* case[12] the Court has decided, after hearing the Advocate General, to proceed to judgment without an Opinion, which could indicate that the next step is to proceed by reasoned order.

Independently of the ECJ giving its ruling on the referred issue by judgment or reasoned order, it will probably consider that both the freedom of establishment and the freedom of capital may be involved, since the domestic regime exempted resident shareholders from withholding taxes if the holding amounted to at least 10% or to an acquisition amount not less than EUR 200,000,00.00, and it should be kept for a minimum period of one year before the distribution of the dividends: the purpose of the legislation does not seem to only apply to investment holdings granting them definite influence.[13] If the Court applies a factual test – whether in

[10] ECJ 14 December 2006, C-170/05, *Denkavit Internationaal BV, Denkavit France SARL.* Refer also to ECJ 8 November 2007, C-379/05, *Amurta;* ECJ 19 November 2009, C-540/07, *Commission vs. Italy* and ECJ 3 June 2010, C-487/08, *Commision vs. Spain.*

[11] See Dourado, Is it Acte clair? General Report on the role played by CILFIT in direct taxation, in Dourado/da Palma Borges (eds.) *The Acte Clair in EC Direct Tax Law* (2008) pp. 13 et seq.

[12] ECJ 3 June 2010, C-487/08, *Commision v. Spain.*

[13] See ECJ 24 May 2007, C-157/05, *Holböck,* paras. 22 and 23; ECJ 12 September 2006, C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas*, paras. 31-33; ECJ 3 October 2006, C-452/04, *Fidium Finanz*, paras. 34 and 44-49; ECJ 12 December 2006, C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*, paras. 37 and 38; ECJ 12 December 2006, C-446/04, *Test Claimants in the FII Group Litigation*, para. 36; and ECJ 13 March 2007, C-524/04, *Test Claimants in the Thin Cap Group Litigation*, paras. 26 to 34.

the concrete case there is definite influence or not – that will imply that one or another fundamental freedom will be at play, depending on the case.[14]

Moreover, the Portuguese referring court could have decided the case on the basis of the Acte Clair doctrine, taking into account that the domestic legislation was discriminatory and by analysing whether the bilateral tax treaty with Spain allowed for the necessary neutralization of the discriminatory effects caused by the Portuguese unilateral legislation.

It is settled case law that the situations of residents and non-residents regarding taxation of dividends (outbound dividends) are comparable: according to the ECJ, 'as soon as a Member State, either unilaterally or by way of a convention, imposes a charge to tax on the income, not only of resident shareholders, but also of non-resident shareholders, from dividends which they receive from a resident company, the situation of those non-resident shareholders becomes comparable to that of resident shareholders'.[15] This includes parent companies receiving dividends paid by resident subsidiaries, whether they receive those dividends as resident parent companies or as non-resident parent companies which have a fixed place of business in Portugal, or as non-resident parent companies which do not have a fixed place of business in Portugal.[16]

It is also clear that it is due to the exercise of the power of taxation by the host State (in this case, Portugal) that, irrespective of any taxation in another Member State, a risk of a series of charges to tax or economic double taxation may arise. In such a case, in order for non-resident companies receiving dividends not to be subject to a restriction forbidden by a fundamental freedom, Portugal is obliged to ensure that non-resident shareholder companies are subject to the same treatment as resident shareholder companies.[17]

Since Portugal has chosen to relieve its residents of a liability to tax dividends, it must extend that relief to non-residents to the extent to which an imposition of that kind on those non-residents results from the exercise of its tax jurisdiction over them.[18]

14 ECJ 18 June 2009, C-303/07, *Aberdeen Property Fininvest Alpha Oy*, paras. 33 and 34; ECJ 12 December 2006, C-446/04, *Test Claimants in the FII Group Litigation*, para. 38, and ECJ 26 June 2008, C-284/06, *Burda*, para. 72.

15 ECJ 12 December 2006, C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*, para. 68; ECJ 14 December 2006, C-170/05, *Denkavit France*, para. 35; ECJ 8 November 2007, C-379/05, *Amurta*, para. 38 and ECJ 19 November 2009, C-540/07, *Commission v Italy*, para. 52.

16 ECJ 14 December 2006, C-170/05, *Denkavit France*, para. 36.

17 ECJ 12 December 2006, C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*, para. 70; ECJ 8 November 2007, C-379/05, *Amurta*, para. 39; and ECJ 19 November 2009, C-540/07, *Commission vs. Italy*, para. 53; and ECJ 3 June 2010, C-487/08, *Commision vs. Spain*, para. 52.

18 ECJ 12 December 2006, C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*, para. 70; and ECJ 14 December 2006, C-170/05, *Denkavit France*, para. 37

II.3. The role of bilateral tax treaties

Since, according to the facts, an unfavourable treatment of non-resident shareholders also results from the application of the aforementioned tax treaty by Portugal (15% on 50% of the outbound dividends), it is necessary to analyse whether this bilateral tax convention entitles the taxpayer to a full tax credit, enabling Portugal in ensuring compliance under the then EC Treaty.[19]

In fact, it is necessary for this purpose that the application of the bilateral treaty allows the effects of the difference in treatment under national legislation to be compensated for. The ECJ clarified in the *Commission vs. Italy* and *Commission vs. Spain* cases that the difference in treatment between dividends distributed to companies established in other Member States and those distributed to resident companies does not disappear unless the tax withheld at source under national legislation can be set off against the tax due in the other Member State in the full amount of the difference in treatment arising under the national legislation.[20]

In order to achieve that result, the application of the method of deduction relied on by Portugal should enable the tax on dividends levied by it to be deducted in its entirety from the tax due in Spain, such that if the dividends received by that company were ultimately taxed more heavily than the dividends paid to companies resident in Portugal, that heavier tax burden could no longer be attributed to Portugal, but to Spain (the Member State which exercised its power to impose taxes).[21]

However, in the present case, Article 23 (1) a) of the tax treaty between Portugal and Spain provides that the amount deducted or set off in respect of tax withheld in Portugal cannot exceed the fraction of the tax in Spain, calculated before the deduction, corresponding to taxable income in Portugal.[22]

Therefore, the difference in treatment could only be neutralized where the dividends from Portugal are sufficiently taxed in Spain, which was not the case. In the *Secilpar* case, the dividends were exempted in Spain and the amount that had been withheld in Portugal or a part thereof could not be deducted. In other words, the difference in treatment arising from the application of national legislation cannot be compensated for by applying provisions of the double taxation convention.[23]

19 ECJ 12 December 2006, C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*, para. 71; ECJ 8 November 2007, C-379/05, *Amurta*, para. 79; ECJ 19 November 2009, C-540/07, *Commission vs. Italy*, para. 36, and ECJ 3 June 2010, C-487/08, *Commission vs. Spain*, para. 58.

20 ECJ 19 November 2009, C-540/07, *Commission vs. Italy*, para. 37; and ECJ 3 June 2010, C-487/08, *Commission vs.Spain*, para. 59.

21 ECJ 3 June 2010, C-487/08, *Commission vs. Spain*, para. 60.

22 ECJ 3 June 2010, C-487/08, *Commission vs. Spain*, para. 61.

23 ECJ 19 November 2009, C-540/07, *Commission vs. Italy*, para. 38; ECJ 3 June 2010, C-487/08, *Commission vs. Spain*, para. 62.

III. *Commission vs. Portugal* (C-493/09): Pension Funds

The Commission announced that it first asked for information regarding the taxation of foreign pension funds under formal enquiries in May 2007[24] following complaints received from the pension funds industry. The action was also justified by its interpretation of the *Denkavit* case[25] to the effect that "*higher taxation of outbound dividend and interest payments than of domestic dividend and interest payments is not in conformity with the Treaty freedoms*" and where pensions funds were concerned that higher taxation could "*result from the levying of withholding taxes on dividend and interest payments*". Later, the Commission decided to further pursue the existing infringement procedure by sending a Reasoned Opinion to Portugal.

The Commission claimed that Portuguese tax law "*exempts the dividends received by domestic pension funds and levies a withholding tax of 25% on dividends paid to pension funds established elsewhere in the EU or in the EEA/EFTA countries*"[26] and that the resulting higher taxation results in a restriction of the free movement of capital and, where a controlling participation is concerned, the freedom of establishment protected by the TFEU (EC Treaty).

Portugal has failed to reply to the Reasoned Opinion in a satisfactory manner according to the Commission and hence a case was brought before the ECJ.

IV. IP/10/662: Rules under which certain dividend payments to foreign companies (outbound dividends) may be taxed more heavily than dividend payments to domestic companies (domestic dividends)

The Commission first notified Portugal of a Reasoned Opinion and a request for its tax legislation to be amended with regard to the higher taxation of outbound dividends in comparison to domestic dividends in July 2006.[27] However, Portugal did not reply to this Reasoned Opinion and after the ECJ rendered its decision in the *Denkavit* case, the Commission announced it had decided to take Portugal to the ECJ (albeit conceding that the neutralizing effect of "*whether the State of residence of the parent company gives a tax credit for the withholding tax levied by the source State*" should be reflected in its applications to the Court).[28] In 2007 Portugal amended it tax legislation, which significantly reduced the differences in tax treatment from domestic and outbound dividends. The possible higher taxation of dividends from 2007 onwards can be said to be limited to cases where an economic double taxation partial relief (50%) is granted to domestic parents on dividends received by distributing Portuguese subsidiaries dividends that does not seem available to EU parents of the same subsidiaries (albeit both domestic and outbound distributions are subject to the same withholding tax upon distribution). Recently, under the 2011 Budget proposal that is expected to enter into force in 1 January 2011, the economic double taxation partial relief of 50% established for domestic parents will be abolished and hence from 2011 onwards the treatment of domestic parents will be aligned with that established for foreign parents. Although the Commission announced its decision in June 2010, the authors have no knowledge that such an action has already been brought before the ECJ.

[24] Cf. IP/07/616 of 7 May 2007.
[25] ECJ 14 December 2006, C-170/05, *Denkavit France*.
[26] Cf. IP/08/712 of 6 May 2008.
[27] Cf. IP/06/1060 of 25 July 2006.
[28] Cf. IP/07/66 of 26 January 2007.