



# VECO TAX

## News

Periodical review of the latest international tax news published by Verga Group  
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### EUROPEAN UNION

#### *Parent-Subsidiary Directive and right of usufruct*

On 22 December 2008, the European Court of Justice (ECJ) handed down its judgment on *Les Verges du Vieux Tauves* (C-48/07). The case was concerned with whether the benefits provided by the Parent-Subsidiary Directive (90/435/EU) to companies that own shares in another company are also available for shares held in usufruct.

#### *The case*

A Belgian company (VVT) had held the right of usufruct over the shares in another Belgian company (Narda) for some years. VVT received the profits from the shares held in Nardo in usufruct, which were treated as dividends for tax purposes and as such eligible for the participation exemption under Belgian law.

Following an investigation by the tax authority, according to whom the usufructuary's rights are not the same as those of the owner (which would mean the dividends were wholly taxable), the Belgian Court of Appeal decided to refer the question of whether the usufructuary is eligible for the participation exemption to the ECJ.

#### *Decision*

The ECJ did not follow the opinion in the conclusions of the Advocate General, but held that from the wording of article 3 of the Parent-Subsidiary Directive the right of usufruct is not included in the concept of holding in the capital.

The Court reasoned that the legal position of the usufructuary is not such as to endow it with the status of shareholder.

The Court also stated that, if the domestic laws of a member state envisage the same tax consequences for full property and usufructuary rights over shares in resident companies, but do not grant similar treatment for usufructuary rights over shares in companies resident in other member states, they would be violating the principle of freedom of circulation guaranteed by the EU Treaty.

#### *Observations*

With this sentence, the Court appears to favour a more formal approach, by holding that the benefits of the Directive only apply in the case of legal ownership of the capital of a company. However, in a previous case similar to this but regarding non-EU companies, the Supreme Court of Luxembourg ruled that the right of usufruct carried the same tax consequences as full ownership of the shares provided the former was economically related to the latter.

### EUROPEAN UNION

#### *Consultancy services to holding companies and taxation*

On 6 November 2008, the European Court of Justice (ECJ) gave its judgment on the correct interpretation of article 9 of the Sixth VAT Directive concerning the place of payment of VAT on ser-

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vices provided to an entity whose business activity falls outside the scope of the VAT Directive but which also carries on a taxable activity, though on a marginal basis.

#### *The case*

In addition to its normal activities (which fall outside the scope of VAT directives), a Swedish foundation also supplies consultancy services, albeit in a marginal context, which are wholly taxable for VAT purposes.

To enable it to carry on the exempt activity, the foundation receives consultancy services, which are taxable.

The dispute regards the correct application of VAT on said services, which, according to EU law, are considered as provided in the place of residence of the customer (in this case, the foundation), provided the recipient is a taxpayer for the purposes of the Sixth VAT Directive (otherwise the services would be considered to be supplied in the service provider's country of residence).

#### *Decision*

The Court held that the rules pursuant to article 9 of the Sixth Directive concerning the place of supply must be considered on a same level.

It went on to state that article 9 does not apply only if the taxable person receiving the supply of services uses those services for the purposes of his economic activity.

Therefore article 9 must be interpreted as that the customer, for consultancy services supplied by a taxable person established in another member state is to be regarded as a taxable person, regardless of whether he carries out an economic (or non-economic) activity and of whether the VAT on the foreign supply is used for the purposes of that activity.

#### *Observations*

In the case-law of the ECJ, in theory the mere acquisition and holding of interests in companies does not constitute an economic activi-

ty within the meaning of the VAT Directives.

The principles of this decision are not confined to foundations. They are equally applicable to holding companies that pursue an economic activity within the scope of the Sixth Directive, even if that activity is only a marginal part of their business. Such holdings are (always) considered as VAT taxpayers (and as such are subject to the requirements for registration, payment and statements). Thus if, on the contrary, they receive consultancy services and do not carry on any economic activity, all VAT obligations are borne by the tax-paying service provider.

### **ITALY**

#### *Tax "transparency" to include indirect interests in foreign controlled companies*

**O**n 23 October 2008 the Italian tax authority issued ruling No. 400 on the application of CFC rules (article 168 of the Italian Income Tax Code) to participations held in certain companies resident in tax havens.

The case concerned the applicability of article 168 of the Italian Income Tax Code to certain companies (SPVs), resident in countries with a privileged tax regime, which are wholly owned, through a trust, by an Economic Interest Group (EIG) resident in France and in turn owned in equal shares by a French economic operator and an Italian corporation.

The latter requested a ruling to prevent application of the provisions of article 168, on the grounds that the income of the SPVs, interposed by the EIG, is not sourced in a country with a privileged tax regime, since it is attributed by virtue of the flow-through system to the EIG, resident in France (which operates an ordinary tax regime), which in turn uses the same flow-through method to attribute it to its shareholders (including the Italian corporation).

In a previous ruling, the Italian tax authority had held the CFC rules not applicable when, considering the total amount of taxes paid by the group, the sourcing of income in a country with a favourable tax regime does not produce effective benefits (see ruling No. 63/E of 2007).

With the current ruling, the tax authority considers article 168 of the Italian Income Tax Code to be applicable solely due to the fact that the income of the foreign subsidiary is sourced in a country with a privileged tax regime, and derived from a source of production in said country, regardless of whether the foreign entity is considered transparent or opaque for tax purposes (and thus without considering the total amount of tax paid by the group).

In the ruling, some parts of which are somewhat concise, the tax authority does not appear to have considered the impact of treating the income of the foreign subsidiary as transparent for tax purposes (the income should be attributed to the entity resident in Italy by virtue of the flow-through method). This interpretation leaves room for double taxation.

### **ITALY**

#### *Transfer of residence abroad during the year*

**O**n 3 December 2008 the Italian tax authority issued ruling No. 471 concerning a case in which an individual transferred his place of residence from Italy to a foreign country (Sweden), during the year, and had his name taken off the population register A.T.R.E. in July (thus after the 183 day term required by article 2 of the Italian Income Tax Code).

The taxpayer asked to be considered tax resident in Italy only up to the date of cancellation from the A.T.R.E., and for his Italian-sourced income to be taxed in Italy up to that date. According to the taxpayer, this request was backed by a number of points in the

Commentary to the OECD Model Tax Treaty.

The Italian tax authority stated that Italian law makes no provision for periods of residence of less than one year. It also pointed out that this rule does not affect the conventional definition of residence in the OECD Commentary either (nor is it included in the bilateral agreement with Sweden).

In the case of dual residence (the individual was also resident in Sweden under domestic tax law), reference must be made to the tie-breaker rules set out in the relative treaty and explained in the OECD Commentary in order to avoid the risk of double taxation.

This specific case underlines the importance of timing when taxpayers intend to transfer their place of residence from Italy to a foreign country, or vice versa.

## ITALY/SWITZERLAND

### *Controlled foreign companies (CFC) legislation and Swiss-located companies*

On 10 November 2008 the Italian tax authority issued ruling No. 427 on the fact that a Swiss company (Beta) that benefits from a special flat-rate tax regime falls within the scope of CFC rules pursuant to article 167 of the Italian Income Tax Code, even if actual business activities are carried on in Switzerland.

More specifically, the parent company, Alfa, had requested a ruling to prevent the application of the provisions of article 167 of the Italian Income Tax Code on the grounds that, although benefiting from a privileged tax regime, Beta was in fact engaged in the pursuit of an economic activity in Switzerland, where it had its premises and staff.

The tax authority somewhat unexpectedly held that, although Beta was engaged in the sale and distribution to an international clientele

of goods that were not produced in Switzerland (international trading activities), it could not be considered to be established in Switzerland. Since there were apparently “no economic, political, geographical or strategic connections” between Beta and Switzerland, there were no “appreciable financial-business reasons” for setting up a company in that country. This interpretation of article 167 of the Italian Income Tax Code by the Italian tax authority is apparently based on a number of reasons provided by the Swiss tax authority concerning EU “state aid” rules. Besides appearing highly discriminating, it also appears to be against the spirit of CFC legislation, in that it ought to be possible to prevent the application of such rules provided the entity located in a country with a privileged tax regime, where it carries on its actual business activities, meets certain essential requirements.

In the ruling, the Italian tax authority apparently makes a distinction according to the type of business that is conducted (trade is too “vague”). Moreover, the ruling acknowledges compliance with the essential requirements (offices and staff), which alone should be sufficient proof of the “economic, political, geographical or strategic” connection deemed crucial by the tax authority in order to avoid the application of the rules in question. Since the company has offices and staff in Switzerland, its positive contribution to the Swiss economy is obvious.

It is widely hoped that the tax authority will reconsider the interpretation provided in this ruling, to avoid any unjustifiable discrimination against Italian investments in Switzerland. The reasoning of the tax authority would paradoxically result in the profits of a Swiss company benefiting from a privileged tax regime and with premises, equipment and hundreds of employees in Switzerland, also being taxed in Italy on the basis of a flow-through approach.

## LUXEMBOURG

### *Savings Directive and non-domiciled residents*

On 27 November 2008 the European Commission formally requested that Luxembourg amend legislation which incorrectly transposes certain provisions of the EU Savings Tax Directive (2003/48/EC). The request took the form of a reasoned opinion.

More in detail, Luxembourg provides exemption from withholding tax for payments of interest on current accounts to beneficial owners who benefit from non-domiciled resident status in their country of residence. This status is granted by some member states, which tax foreign-sourced income remitted and/or used within the country.

The Commission considered this exemption to be incompatible with the meaning of the provisions of the Savings Tax Directive, also in view of the fact that the situations in which exemption from withholding tax can be granted are those provided and expressly governed by article 13 of the Directive and only regard cases in which the beneficial owner expressly authorises the paying agent to report information to the competent tax authority.

In accordance with EU law, the paying agent must establish whether the beneficial owner is resident in a member state. In that respect, non-domiciled residents must be taxed in the same way as EU residents and, as such, are subject to the provisions of the Savings Tax Directive.

## United Kingdom

### *Place of effective management of a trust*

In 2008, UK Special Commissioners handed down an interesting decision on the concept of the place of effective management of trusts.

### *Description of the case*

A British trust relocated to Mauritius and appointed a Mauritius-resident trustee in order to shelter gains on the sale of quoted shares from tax. The shares were then sold and the relative gain was only subject to capital gains tax in Mauritius, by virtue of the UK-Mauritius tax treaty. After selling the shares, the trust was moved back to the UK and once again appointed a UK-resident trustee.

### *The decision of the UK court*

The UK court agreed that the actions and decisions of the new Mauritius trustee were carried out correctly and were well documented, but noted that these had been strongly influenced by the UK settler and guided by the UK tax advisers. In other words, the court held that the place of effective management was in the UK, as that was where the key decision to sell the shares, which constituted a large proportion of the trust's assets, was made, even before the trustee was moved. The Commissioners described the place of effective management as the place of realistic or positive management of the trust.

Another interesting point is that the UK Commissioners did not challenge the (fictitious) transfer of residence, on the assumption that the ultimate purpose of the entire transaction was to take advantage of the favourable tax regime for capital gains in Mauritius. On the contrary, after a close analysis of the facts and documentary evidence and careful examination of the terms of the UK-Mauritius tax treaty, they concluded that the place of effective management had always remained in the UK.

Thus if the place of residence had actually been transferred (i.e. if the place of effective management had been transferred) the capital gains would have been exempt from tax.

It is also important to note that the UK tax authority presented the tax tribunal with significant and substantial documentary evidence

of the business and professional relationships between the people involved (settlor, trustees, tax and financial advisers), and provided details of how key decisions (disposal of shares) were made in the UK.

## **UKRAINE**

### *Limitations for tax exemption on dividends paid to Dutch companies*

Dutch companies are valid corporate vehicles for investment in Ukraine. This is because, in addition to the flexibility of Dutch company law, under article 10(3) of the Netherlands-Ukraine tax treaty no withholding tax is levied on dividends paid by a Ukraine company to a Dutch company (instead of the ordinary rate of 15 percent under domestic law). However, the exemption is only available for Dutch companies that own at least 50 percent of the Ukraine company's capital and provided the investment amounts to at least 300 thousand US dollars.

In a recent circular letter, the Ukraine state tax authority provided an interpretation of the minimum investment requirement in order to qualify for exemption from withholding tax on dividend payments (at least 300,000 US dollars). According to the tax authority, zero withholding tax only applies if the investment is made directly by the shareholder in the form of a single payment.

It follows, from this interpretation, that exemption is not available for capital subscribed in kind (e.g. by way of contribution of immovable property), payments made in several instalments or for dividends paid to a shareholder other than the shareholder who made the remittance (e.g. following incorporation into another company).

If the above exemption is not applicable, but the Dutch company holds at least 20 percent of the Ukraine company's capital, a 5 percent tax is levied.

According to the Dutch Ministry of Finance the interpretation of article 10(3) provided by the Ukraine tax administration is disputable. Although the letter is not legally binding, the local tax authority is likely to enforce all the opinions stated in it. Lastly, the opinions stated in the circular letter may apply retrospectively (thus also in relation to previous years' profits still to be distributed).

## **JERSEY**

### *Variation of a trust*

In the Turino Trust case the Royal Court of Jersey confirmed that a decision of a foreign court cannot vary a trust.

In the case in question, the Dutch court had ruled that a house, purchased by a couple at the time of their marriage and placed in trust, should be split equally between the parties despite the fact that the husband had originally contributed most of the funds necessary to purchase the house, upholding the terms of the trust (i.e. the 83 percent to 17 percent split).

The Jersey court ruled that the house should be sold to the wife, at a fair price, and that the proceeds of the sale should in turn be distributed between the beneficiaries of the trust (husband and wife) according to the terms of the trust. However, in the case in question, the assets were split equally (50 percent each) since, some time after setting up the trust, the rights of the beneficiaries had been altered with the consent of both parties, in what was termed as a letter of wishes (rule in Saunders vs. Vautier).

In any case, it is interesting to note that the Royal Court of Jersey upheld that it cannot enforce or give effect to any judgment of a foreign court which purports to vary a trust as it cannot give effect to an order which it has no power to make or which the trustees have no power to carry out.