

April 2011

European Tax Brief

Tax

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Editorial

Welcome to this, the first issue of Moore Stephens *European Tax Brief*. This newsletter summarises important recent tax developments of international interest taking place in Europe and other countries within Moore Stephens European Region. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information

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zigurds.kronbergs@moorestephens-europe.com



Inside

“It is proposed in a new bill that the exemption method be applied to all dividends from the European Union, the European Economic Area and third countries.”

Page 3

“The Commission has already identified the CCCTB as an important initiative in the context of the Europe 2020 Strategy.”

Page 4

“The government will also proceed with the introduction of a Dutch-style ‘patent box’ under which profits from UK-based intellectual property would be taxed at a reduced rate of corporation tax.”

Page 9

Austria

ECJ strikes down aspects of foreign portfolio dividend taxation

The European Court of Justice (ECJ) has held that Austria's system for taxing portfolio dividends received from abroad by Austrian companies was in several respects not in compliance with European law. Several features of that system have already been changed in advance of the judgment.

In the joint cases of *Haribo* and *Salinen*, (*Haribo Lakritzen Hans Riegel BetriebsgmbH v Finanzamt Linz* and *Österreichische Salinen AG v Finanzamt Linz*, Cases C-436/08 and C-437/08), in which judgment was delivered on 10 February, the taxpayer companies, resident in Austria, had invested in tax-transparent investment funds, some of the dividends received by which originated from companies in other EU Member States, other EEA states or third countries. Because the funds were transparent, the Austrian companies were treated for tax purposes as receiving those dividends directly.

Under the law as it stood at the time, whereas dividends received from other Austrian companies were exempt from Austrian corporate tax (under the so-called 'participation exemption') whatever the size of the underlying shareholding, dividends received from abroad were in principle exempt only if the shareholding exceeded a certain percentage of the investee company's capital. This threshold percentage was initially 25%, and was reduced to 10% for tax assessments covering fiscal periods from 2004 onwards. The shareholdings in question in the case fell below both thresholds. At the same time, the minimum period during which the required level of shareholding had to have been held was reduced from two years to one year.



In addition to the lowered threshold, further changes have been made to the treatment of foreign dividends. In 2009, the exemption method was extended to dividends from other EEA states, irrespective of the size of the shareholding, providing (*inter alia*) that the company paying the dividend was comparable to the types of company listed in the EC Parent-Subsidiary Directive (90/435/EEC) – in effect most types of straightforward companies with share capital – and there was a mutual administrative and enforcement agreement. Of the three EEA states outside the European Union, only Norway has such an agreement with Austria. This 2009 amendment was applicable to all open cases at that time, i.e. also for the *Haribo* and *Salinen* cases.

If the dividends were paid by a company resident in another EU Member State, the participation exemption did apply, regardless of the size of the shareholding, if certain conditions were met. These conditions included the proviso that the foreign company had to be subject to a tax on profits at a rate no more than 10 percentage points lower than Austria's corporate tax rate (i.e. a rate no lower

than 15%). Within the European Union, Bulgaria (10%), Cyprus (10%) and Ireland (12.5% on trading profits) fail this test. The same conditions applied where the dividend came from an EEA state outside the European Union (i.e. Iceland, Liechtenstein or Norway), provided, further, that Austria had concluded an agreement on mutual assistance in tax administrative matters and an agreement on enforcement (assistance with recovery of taxes) with that state.

Where it could not be shown that the foreign company was subject to the stipulated minimum rate of corporate tax, the dividends were taxable in Austria, but a tax credit was given for the foreign tax, up to the limit of Austrian corporate tax payable on the dividend ('the credit method'). The same held good for dividends distributed by certain companies deriving mainly passive income. The foreign tax for which credit was given in these circumstances included the corporate tax suffered on the profits out of which the dividend was paid ('underlying tax') and any foreign withholding tax on the dividends themselves (if provided in the respective treaty). However, where the foreign tax credit exceeded the Austrian tax due (e.g. because the Austrian company had incurred a loss), the excess could not be carried forward. There was no exemption or tax credit for portfolio dividends from outside the EEA under Austrian domestic tax law.

After the tax authorities refused exemption and credit for certain dividends, the taxpayer companies appealed to the relevant domestic court, which referred questions to the ECJ (and after the 2009 amendments, which were applicable for all open cases, referred them anew). The European Court has >>

now found as follows:

- It was not in breach of Article 63 TFEU (free movement of capital) for Austria to have an exemption method for domestic portfolio dividends and a credit method for foreign portfolio dividends, whether those dividends came from another Member State, another EEA state or from a third country, provided that administrative burdens on the recipient company were not excessive, and they were not excessive in these cases;
- It was in breach of Article 63 for Austria to insist on the existence of a mutual enforcement agreement for the participation exemption to apply to dividends from other EEA states; a mutual administrative assistance agreement was sufficient;

- It was in breach of Article 63 for no exemption or credit method of avoiding double taxation to be available for portfolio dividends from third countries whereas exemption was available for domestic portfolio dividends;
- It was in breach of Article 63 for there to be no carry-forward of excess foreign tax credits in respect of underlying tax for portfolio dividends taxed under the credit method.

As a result of the ECJ's decision, it is now proposed in a new bill that the exemption method be applied to all dividends from the European Union, the European Economic Area and third countries, irrespective of the size of the shareholding, provided only that there is

a mutual administrative assistance agreement with the country concerned; a mutual enforcement agreement will no longer be necessary. Furthermore, where the credit method is used, it will be possible to carry excess credits forward, where they relate to underlying tax, but not withholding tax. These new rules are expected to apply from 1 January 2011.

t.wallnoefer@citytreuhand.at



Belgium

Participation exemption extended to EEA companies

Among various tax measures included in a recent Act of Parliament is an extension of the participation exemption deduction to companies resident in other states of the European Economic Area (EEA).

Under the participation exemption, a Belgian company may deduct 95% of dividends received from other Belgian companies and companies resident in other EU Member States

when calculating its taxable profits. The remaining 5% is taxable. Where a company has insufficient taxable profits for the full 95% to be deducted, the excess deductible amount may be carried forward.

This treatment is now extended to dividends received from subsidiaries resident in EEA Member States outside the European Union, i.e. Iceland, Liechtenstein and Norway.

The previous requirement that the shareholdings in respect of which the dividends are paid must be a 'fixed financial asset' of the Belgian company has been repealed, following the European Commission's opinion that it is in breach of the EC Parent-Subsidiary Directive (90/435/EEC). Where a liquidation bonus from a company resident in another EU Member State is received in connection with a cross-border merger, it is fully deductible for tax purposes. This exemption has also been extended to dividends received from subsidiaries resident in any EEA state.

These changes came into effect on 1 January 2011.



jan.bulkmans@moorestephens.be

Czech Republic

Tax reform proposals

The Czech government has announced details of the proposed tax reform, which is intended to take effect from 2013. The proposals affect both individual and corporate income taxes and social security contributions.

Taxation of individuals

The current flat-rate income tax of 15% would be increased to 19% (in line with the rate of corporate tax). The current personal tax credit (CZK 24 840) would be abolished for taxpayers with a taxable income greater than four times the average salary (i.e. currently where greater than CZK 296 875 per annum).

Social security contributions, currently totalling 10.5% (4.5% health contributions and 6% other social

security contributions) would be increased to 13% (6.5% for both). The ceiling for the health contribution would be six times the average salary and for the social contribution, four times.

The basis of assessment for income tax and social security contributions would be unified.

Employers

Employers currently pay 34% in combined social security contributions (of which the health component is 9%). The separate contributions would be replaced by a single employer's contribution of 32%.

Both employer's and employee's contributions are currently subject to



a ceiling, which is set for 2011 at CZK 1 781 240 in a full year.

Taxation of companies

Companies would benefit from simpler procedures for creating reserves and bad-debt provisions. There would be unlimited carry-forward of excess foreign tax credits on dividends.

The proposals may well be subject to change.

robert.jurka@moorestephens.cz

European Union

CCCTB proposal launched

After preparatory work extending over some ten years, the European Commission finally launched its proposals for a Common Consolidated Corporate Tax Base (CCCTB) for multinational companies doing business in more than one EU Member State on 16 March. The proposals took the form of a draft directive.

The Commission believes that the CCCTB would make it easier and cheaper to do business in the European Union, by reducing the administrative burden, compliance costs and legal uncertainties that businesses currently face in having to comply with up to 27 different national systems for determining their taxable profits. By adopting the CCCTB, which would be optional, companies would be able, according to the Commission, to benefit from a 'one-stop shop' system for filing their tax returns and would be able to consolidate all the profits and losses they derive across the European Union.

The CCCTB is a single, uniform set of rules for computing the corporate tax base (taxable income or loss) for a company and its qualifying subsidiaries operating in more than one EU

Member State and would allow companies and groups to file a single consolidated corporate tax return with a single tax authority. That tax base would then be shared out amongst the Member States in which the company or group operates according to a specific formula taking into account three factors – assets; labour and sales. Member States would remain free to tax their allocation at whatever rates they chose. The Commission is keen to stress that adoption of the CCCTB neither requires nor implies a harmonisation or convergence of corporate tax rates, the setting of which would remain entirely the prerogative of the Member States.

The CCCTB would by its very nature allow cross-border loss relief, something that currently may only take place under extreme circumstances, or in very few Member States' tax systems. It would also remove the need for transfer pricing rules, which determine how intra-group transactions are taxed, within the European Union. As the CCCTB would be entirely optional, it would sit alongside and not replace the Member States' corporate tax systems.

The Commission has already identified the CCCTB as an



important initiative in the context of the Europe 2020 Strategy (its growth strategy for this decade) and its lack as a serious obstacle to completion of the single market.

Opinions on the CCCTB outside the European Commission vary. The attitude from the business world is broadly favourable. The view of Business Europe, the pan-European business and employer organisation, is that "Obstacles to cross-border activity in the field of corporate taxation hamper business development and the growth potential of the Single Market. The proposal to develop a Common Consolidated Corporate Tax Base could help and is welcome under the condition that it remains a competitive option for companies and excludes any form of tax rate harmonisation". The majority in the European Parliament is also broadly in favour. The trade unions, although slightly more sceptical, are not opposed in principle. Indeed, the European Trade Union Confederation wrote to the incoming Belgian Presidency in June last year calling for the CCCTB initiative to go ahead.

Several Member States, however, are hostile, notably Ireland, where the business community shares the same negative view. IBEC, the Irish Business and Employers Confederation, believes the CCCTB would actually make investing in Europe less attractive, and cites an Ernst & Young study (commissioned by IBEC and others) that concluded the CCCTB would increase compliance costs by 13%.

As taxation matters still require unanimity among Member States, it is unlikely as things stand at present that the Directive will be adopted in the near future, but, as with the common European patent, it could be the subject of so-called 'enhanced cooperation', under which a minimum of nine Member States may agree to proceed with an initiative amongst themselves, leaving the others to join it at any time if they so wish.

zigurds.kronbergs@moorestephens-europe.com

Germany

German tax group may now include EEA companies

By decree of the Ministry of Finance, from 28 March 2011, a German tax group (*Organschaft*) may now include members that are companies incorporated in another EEA state but effectively managed (and hence resident) in Germany, and such members (*Organgesellschaften*) may transfer their taxable profits or losses to the parent company (*Organträger*). It remains the case that only a German incorporated company may be an *Organträger*.

Previously, only German incorporated companies have been eligible to be members of an *Organschaft*. The European Commission advised Germany last year that it would bring a case against Germany to the European Court if it did not alter this rule, considered to be in breach of European law.

ragnar.koenemann@moorestephens.de

Latvia

Manufacturers receive tax boost

Companies engaged in designated industry sectors will receive significant tax reliefs on large investments in qualifying assets as from 1 January this year. The new reliefs are a return to the types of tax incentive that existed in Latvia before 2005 at a time of higher corporate tax rates. Latvia is still slowly recovering from a deep recession and financial crisis, which hit the country in 2008.

Under the new relief, a tax credit of 25% of the amount invested, up to LVL 35 million, will be given, together with a further 15% of the amount exceeding LVL 35 million. The minimum qualifying investment is LVL 5 million.

Excess credits may be carried forward for a maximum of 16 taxable periods.

The investment must be approved by the government and the investment must be completed within three years of approval. Qualifying industrial sectors are those falling within certain NACE categories and include:

- The manufacture of beverages and

certain foodstuffs;

- Chemicals and certain pharmaceutical products;
- Computer and optical products;
- Electrical equipment;
- Telecommunications;
- Motor vehicle and trailer manufacture.

The investment must:

- Begin a new operation;
- Modernise or extend existing operations so as to enable the manufacture of a new product line or the provision of a new type of service;
- Make a significant alteration to an existing operative process.

The premises in which the investment is put to use must belong to the taxpayer or be leased for a term of at least 13 years from the date of inception of the investment project. The relief is available for projects approved before 31 December 2013 and completed before 31 December 2016.

moore-stephens@mailbox.riga.lv

Liechtenstein

Corporate and individual taxes reformed

A wide-ranging reform of both corporate and personal taxes took effect in Liechtenstein (which is a member of the *European Economic Area (EEA)* and the *European Free Trade Association (EFTA)*) on 1 January 2011.

Corporate tax

In order to conform to OECD and international norms, without sacrificing Liechtenstein's attractiveness as a business location, the old special régime of holding and domiciliary companies has been abolished. Instead, there is a single corporate income tax at a rate of 12.5% on all legal entities resident in the Principality, subject to a minimum in most cases of CHF 1200.

Additional features of the new corporate tax are:

- A deduction representing notional interest on equity of 4%;
- Exemption for dividends, capital gains and liquidation gains;
- Partial exemption of 80% for income from intellectual property (resulting in an effective tax rate of 2.5%);
- A facility for international group taxation;
- Abolition of the net worth tax (*Vermögenssteuer*) and the coupon tax on reserves.

A new way of taxing wealth-management assets has been introduced, called the 'private asset structure' (*Privatvermögensstruktur – PVS*). It has had the go-ahead from the EFTA Surveillance Authority. A PVS may take the form of an *Anstalt*, a foundation or a company limited by shares. Private individuals may place a part of their assets into a PVS, which is an autonomous legal person. The PVS, which may not engage in economic activities, is taxable on a lump-sum basis of CHF 1200 per year. A PVS may hold financial instruments, shares or other participations in companies and

other legal persons (but not be able to exercise a direct influence on those persons), liquid funds and credit balances on bank accounts.

Existing *Anstalten* (those founded before 1 January 2011) may continue under their existing tax régime for a further three years, but will have to apply for PVS status (assuming that they do not have any economic activities) in due course.

Personal taxation

Under the new Tax Act, capital gains will no longer be taxable and the inheritance and gift tax has been abolished.

DTA network expanded

In addition to concluding OECD-compliant tax information-exchange agreements, Liechtenstein has recently been expanding its network of double taxation agreements (DTAs). In addition to its longstanding DTAs with its neighbours Austria and Switzerland, it has recently concluded four DTAs with similar jurisdictions – Hong Kong, Luxembourg, San Marino and Uruguay. It is the government's declared intention to expand Liechtenstein's network of DTAs in Europe and worldwide, and further to implement the OECD standard on transparency and information exchange.

toendury@toendury.li



Luxembourg

The tax credit for investment in depreciable tangible assets other than buildings, mineral deposits and fossil fuels by a qualifying entity located in Luxembourg has been extended to assets used in any other EEA state.

The investment tax credit is granted at a rate of 7% on the first EUR 150 000 of qualifying new investment and a 3% tax credit is available on the amount exceeding EUR 150 000. An additional 13% tax credit is given on the complementary acquisition value of fixed assets made during the current year. The Luxembourg resident companies or individual traders concerned must be active in certain prescribed sectors of the economy (e.g. industrial or commercial, mining etc). Hitherto, it was a condition that the asset concerned be physically used in Luxembourg.

Last year, the use condition was held incompatible with the freedom to provide services guaranteed by the TFEU by the European Court of Justice in the *Tankreederei* case (Case C-287/10).

Accordingly, Luxembourg has announced that it will be changing its law to permit the qualifying asset to be used anywhere within the European Economic Area. Other conditions will be unchanged.

Pending a change in the law, the new treatment will be applied to all qualifying investments made in 2010 and to any other investments in respect of which the assessment for the relevant tax year is still open.

evelyne.guillaume@moore-stephens.lu

Netherlands

Corporate tax changes

A number of changes, intended to act as incentives for entrepreneurship and innovation, have been made to the corporate tax code with effect from 1 January 2011.

- The main rate of corporation tax has been reduced from 25.5% to 25%. This rate applies to that part of taxable profits in excess of EUR 200 000. The first EUR 200 000 of taxable profits is taxed at 20%, as previously;
- The temporary optional extension of the loss carry-back period from one to three years also applies in 2011 (as it did for 2009 and 2010), but companies opting for the extended carry-back for 2011 losses will have their maximum loss carry-forward period shortened from nine to six years. The maximum loss that may be carried back to a year beyond the immediately preceding year is limited to EUR 10 million;
- The option for accelerated depreciation available in 2009 and 2010 has been extended to 2011. Companies may opt to take up to 50% depreciation each year on prescribed assets, provided that they are brought into use. This means that assets acquired or produced in 2011 could be wholly depreciated by the end of 2012, provided that they are brought into use no later than 31 December 2012;
- Employers of personnel engaged in research and development

may claim a reduction in the salary tax (*loonbelasting*) payable in respect of those employees. In 2011, a reduction of 50% may be claimed on the first EUR 220 000 of the total R&D salary bill and 18% on the remainder, subject to a maximum deduction of EUR 14 million

- The benefit of the so-called 'innovation box' is extended to profits earned from patents and other qualifying innovative activities in the period between the filing of the application and the grant of the relevant patent. Under the innovation box, profits from qualifying activities are taxed at a special 5% rate of corporate tax.

r.vanden.brink@mth.nl



Norway

Cross-border restructuring to be liberalised

The Norwegian government is proposing to liberalise the rules on cross-border restructuring, so that a greater number of these transactions may take place free of tax consequences.

Mergers and demergers

Currently, tax-free restructuring, under which no tax is payable on share and asset disposals, is only permitted where all the companies involved are resident in Norway. Under the new plans, three types of cross-border transactions would also be tax-free under certain conditions.

The transactions envisaged are where:

- A. A Norwegian company is absorbed by a company resident in another EEA state;

- B. A Norwegian company demerges and the surviving company is resident in another EEA state;
- C. Non-resident companies with branches in Norway undergo a merger or demerger.

A condition for all three types of restructuring is that none of the companies involved is resident in a low-tax jurisdiction outside the European Economic Area (EEA). Where one or more companies are resident in low-tax jurisdictions within the European Economic Area, such companies would have to have a real physical presence and be carrying out genuine economic activities in that jurisdiction.

A further condition for type A and type B

restructuring to be tax-free is that the business operations previously carried out in Norway by the Norwegian transferor company continue to be carried on in a Norwegian branch of the transferee/surviving company. A further condition for the type C restructuring to qualify is that the assets located in Norway are not removed from Norway.

Share-for-share exchanges

Another liberalising proposal concerns share-for-share exchanges. Currently, these are subject to tax, but if the exchange takes place between two Norwegian companies, the transferor is taxed on only 3% of the gain (resulting in an effective rate of tax of 0.84%). The government is proposing that



Norwegian-resident shareholders (whether companies or individuals) should be permitted to exchange shares in a company for shares in a foreign company on a tax-free basis, provided that certain conditions are satisfied. As with the proposed cross-border restructuring rules, the foreign company involved may not be resident in a low-tax jurisdiction outside the European Economic Area, and if it is resident in a low-tax jurisdiction within the European Economic Area, it must satisfy the presence and activities test. Share-for-share exchanges between two Norwegian companies would remain subject to the current rules.

NB: the Norwegian companies involved must be either a private limited-liability company (*aksjeselskap* – AS) or public limited-liability company (*almennaksjeselskap* – ASA) and the foreign companies must be comparable (e.g. joint-stock companies, limited-liability companies etc).

Exit tax

A third set of proposals concerns exit tax. Currently, when a company migrates from Norway (i.e. ceases to be resident in Norway for tax purposes), it must pay tax on realised and unrealised gains on its assets. Under the proposals, migration to another EEA state would normally no longer trigger exit tax. If the jurisdiction of destination was a low-tax jurisdiction within the European Economic Area, the presence and substance test would need to be satisfied, and exit tax would still in principle be due, but would only be payable to the extent that any assets were actually realised within five years of the migration.

If enacted, the proposals are expected to take effect from 1 January 2011.

kk@oslo.moorestephens.no



Romania

New electronic payment system

Romania has launched a new system of paying taxes electronically by means of a bank card. Payment can currently be made in this way to a limited number of tax offices only and only by individual taxpayers, but the intention is that all tax offices will accept payment in this way by the end of this year.

laura.stoica@auditone.ro

Sweden

Court holds taxation of non-residents' allowances unfair

Sweden's Supreme Administrative Court (*Högsta förvaltningsdomstolen*) has held that the deduction of salary tax and social security contributions on mileage and *per diem* allowances paid to non-resident employees taxed under the special expatriate régime is unlawful, to the extent that the same allowances paid to resident employees would be exempt.

To the extent that they do not exceed prescribed amounts, certain allowances and *per diem* payments made to Swedish-resident employees are exempt from the withholding of salary tax and from employee and employer social security contributions.

Under the Special Income Tax Act for Non-Residents (*Lag om särskild inkomstskatt för utomlands bosatta* – SINK), expatriates working on short-term assignments in Sweden may opt for a special régime under which their Swedish earnings are subject to a final flat-rate tax of 25% levied on gross remuneration. However, they do not benefit from the exemption for

allowances enjoyed by resident employees, even where the allowances are within the tax-free limits. The SINK régime does not apply to expatriates on longer-term contracts who stay in Sweden for more than six months, as they would normally be considered resident in Sweden.

The court has held that this discriminatory treatment of non-resident employees is in breach of the right to free movement of workers guaranteed under the Treaty on the Functioning of the European Union (TFEU), and that there is no justification for such treatment.

The judgment of the court is final. Employers who have withheld tax and paid social security contributions on payments to expatriates of allowances that would otherwise have been tax-free should consider applying to the tax authorities for a review of their tax position.

jonas.skold@moorestephens.se

United Kingdom

Further cut in corporation tax

A further one-point cut in corporation tax was one of the headline proposals in the Conservative-Liberal Democrat coalition government's second Budget speech, delivered by Chancellor of the Exchequer George Osborne on 23 March.

The main rate of corporation tax was due to fall to 27% (from 28%) as from 1 April, but the Chancellor proposed that it would be set instead at 26% for the financial year 2011 (the year ending 31 March 2012). It will then fall further by one percentage point for the next three years, as already envisaged, stabilising at 23% in the financial year 2014 and subsequent years. The 'small profits rate' payable on taxable profits of GBP 300 000 and less is also reduced, from 21% to 20% as from 1 April. Between GBP 300 000 and GBP 1 500 000, a marginal relief applies so that the average rate on total profits increases gradually from the small profits rate to the full rate.

Other significant new proposals in what was presented as a tax-neutral budget, in line with the deficit-reduction strategy laid down in July 2010, were as follows:

- The government intends to consult on the possibility of integrating the operation of income tax and national insurance (social security) contributions (NICs), but in such a way as not to extend NICs to currently exempt income or taxpayers (e.g. investment income, individuals above state pension age). It will be several years before any such integration has effect;
- A further rise in the rates of the bank levy from 1 January 2012, from which date the rates will be 0.078% on short-term chargeable liabilities and 0.039% on long-term chargeable equity and liabilities;
- The lifetime limit for the reduced 10% rate of capital gains tax on the gains from the disposal of businesses and certain business assets (entrepreneurs' relief) is doubled to GBP 10 million from 6 April 2011;
- The annual charge for use of the favourable remittance basis of taxation of non-domiciled individuals increases to GBP 50 000 for those who have been resident in the United Kingdom for 12 years or more, but income and gains remitted to the United Kingdom in order to invest in a UK business will be exempt from UK tax;
- Income tax relief under the enterprise investment scheme for individuals investing in certain small companies is increased from 20% to 30% as from 6 April 2011. From 6 April 2012, the maximum annual investment, the maximum size of qualifying companies and the maximum amount such companies may raise will all increase;
- The deduction for expenditure by small and medium-sized



- enterprises on research and development will increase from 175% to 200% from 1 April 2011 and to 225% from 1 April 2012 (subject to state-aid approval from the European Union);
- The supplementary charge payable on profits from oil and gas extraction and exploitation is increased from 20% to 32%, from 24 March 2011. However, if the price of oil falls below a fixed trigger price, the charge will be reduced;
- As from accounting periods beginning probably in late July (the exact date will depend on when the Finance Bill becomes law), UK companies with foreign branches may make an irrevocable election to exempt the profits of those branches from UK corporation tax. If they do so, they will also lose the right to set off future losses from foreign branches against their UK tax liability and may face recapture of losses previously set off.

The Chancellor also confirmed that several other measures announced previously would go ahead. These include increases in NICs (see below) and the personal allowance for individual taxpayers, reforms to the controlled foreign company (CFC) rules, reductions in capital allowances (tax depreciation) and several anti-avoidance measures. The government will also proceed with the introduction of a Dutch-style 'patent box' under which profits from UK-based intellectual property would be taxed at a reduced rate of corporation tax. Consultation will proceed on the details. A statutory test to determine the residence status of individuals is also proposed, to take effect from April 2012, following consultation.

Corporate tax:

philip.parr@moorestephens.com

Personal tax:

gill.smith@moorestephens.com

Rise in national insurance contributions

As previously announced, the rate at which employers, employees and the self-employed pay national insurance (social security) contributions increases with effect from 6 April 2011.

For employers, the rate increases from 12.8% to 13.8%, payable on weekly earnings in excess of GBP 136 (previously GBP 110).

For employees, the rates and thresholds are as follows:

2010-11

Earnings band	Rate (%)
First GBP 110	0
Next GBP 734	11
Remainder over GBP 844	1

2011-12

Earnings band	Rate (%)
First GBP 139	0
Next GBP 678	12
Remainder over GBP 817	2

The self-employed pay both a flat-rate weekly ('Class 2') contribution, which will be GBP 2.50 (GBP 2.40 in 2010-11) and a profit-related ('Class 4') contribution. Class 4 rates are as follows:

2010-11

Profits band	Rate (%)
First GBP 5 715	0
Next GBP 38 160	8
Remainder over GBP 43 875	1

2011-12

Profits band	Rate (%)
First GBP 7 225	0
Next GBP 35 250	9
Remainder over GBP 42 475	2

steve.durman@moorestephens.com



Thin-cap GLO taxpayers lose at Appeal Court

In a further twist to the Thin Cap GLO saga, the Court of Appeal has overturned the judgment of the High Court and held (by 2 to 1) that the United Kingdom's thin capitalisation legislation was in compliance with European law on freedom of establishment, and that the taxpayers were therefore not entitled to a repayment of tax.

In its latest incarnation, the UK legislation at issue provides (as part of the transfer pricing legislation) that where interest is paid by a company to a party with which it is under common control, only that part of the interest may be deductible as does not exceed arm's length terms. Before 2004, the legislation did not apply where both parties were within the charge to UK tax.

That the legislation in that earlier form may be in breach of European law first became a possibility after the decision of the European Court in the *Lankhorst-Hohorst* case (Case C-324/00) in December 2002, which held that Germany's particular version of thin capitalisation rules was unlawful under the EC Treaty. Many claims were then filed against the UK rules by UK subsidiaries of multinational groups. These claims were grouped together in a Group Litigation Order (GLO) and two test claimants (Volvo and Lafarge) chosen to go before the courts. In March 2007, the European Court held (in Case C-524/04 – >>

'*Thin Cap*') that the UK thin capitalisation rules were indeed discriminatory, but would not be in breach of what was then Article 43 of the EC Treaty (freedom of establishment), now Article 49 TFEU, if they were intended to prevent abusive practices and did not go beyond what was necessary to attain that objective. It was for the UK courts to decide whether or not that was the case, and it is this litigation that is now proceeding through the courts.

In the High Court in November 2009, the judge held that the rules did go beyond what was necessary, were therefore unlawful, and that the taxpayers were entitled to restitution of tax wrongfully paid. He further ruled that the breach of law was sufficiently serious for them to be awarded damages as well as restitution.

Essentially, the nub of the argument in the Court of Appeal was whether it was sufficient for thin capitalisation legislation to be lawful under Article 49 if it (a) applied the arm's length test; (b) permitted the taxpayer an adequate opportunity to present his case that this was so; (c) allowed for the tax authorities' decision to be challenged in the courts; and (d) limited the amount disallowed to what was in excess of arm's length, or, whether, as a reading of the ECJ judgment suggested, the taxpayer had also to be allowed to present a separate commercial justification even where the arrangements were not at arm's length. The UK rules satisfied (a) to (d) but did not allow for commercial justifications in non-arm's length situations.

The majority held that, based on the 2007 ECJ judgment in *Thin Cap* alone, the decision of the High Court may have been correct. However, since that time, jurisprudence had moved on, and the SGI case (Case C 311/08) in particular established that the inclusion of an arm's length test 'pure and simple' in thin capitalisation legislation is compliant with Article 49, and that there is no need for there to be an alternative test of commerciality where the arm's length test is not satisfied. Accordingly, the United Kingdom's rules had been compliant and no repayment of tax or damages was due.

The dissenting judge argued, on the contrary, that the later cases had not distinguished *Lankhorst-Hohorst*, which was still good law. In that case, the German legislation had made an exception for arm's length cases, but was still found unlawful because it did not allow for an exception for cases where commercial justification could be demonstrated (as in that case) even where the arm's length test was not satisfied. She did, however, agree that if her opinion were correct, there had been no sufficiently serious breach for damages to be awarded in addition to the wrongly paid tax.

Since very substantial sums of money are at stake, and the Court of Appeal was not unanimous, it is almost certain that the case will go before the Supreme Court for a final judgment. Which way that court will decide is far from clear.

philip.parr@moorestephens.com

Commission targets anti-avoidance rules

Two of the United Kingdom's anti-avoidance rules involving foreign assets may be in breach of European law according to the European Commission.

Under section 13 of the Taxation of Chargeable Gains Act 1992, capital gains made by certain foreign companies can be attributed to participators resident or ordinarily resident in the United Kingdom where, broadly, the foreign company is under the control of five or fewer participators or of its directors. Only participators holding 10% or more (counting the holdings of connected persons) may be subject to this attribution.

Under Part 13 Chapter 2 of the Income Tax Act 2007, individuals who are

ordinarily resident in the UK and have the 'power to enjoy' income of person abroad (including the income of a trust or foreign company) directly or indirectly deriving from assets that have been transferred abroad may be taxed on the whole of that income. This is a long-standing anti-avoidance provision, dating back to 1936.

No such attributions can be made under either set of provisions if the holdings were in, or the income accrued to, a UK company. On this basis, the Commission considers the provisions to be incompatible with the freedom of establishment (Article 49) or the free movement of capital (Article 63). In the Commission's opinion, they are disproportionate and go beyond what

is reasonably necessary to combat tax avoidance.

If the United Kingdom does not respond satisfactorily within two months of the Commission's notification on 16 February, proceedings may be initiated before the European Court.

hazel.johnson@moorestephens.com



Currency table

For ease of comparison, we reproduce below exchange rates against the euro and the US dollar of the various currencies mentioned in this newsletter. The rates are quoted as at 11 April, and are for illustrative purposes only.

Currency	Equivalent in euros (EUR)	Equivalent in US dollars (USD)
Czech koruna (CZK)	0.0409	0.0592
Euro (EUR)	1.0000	1.4440
Latvian lats (LVL)	1.4101	2.0380
Pound sterling (GBP)	1.1371	1.6420
Swiss franc (CHF)	0.7611	1.0997

Up-to-the-minute exchange rates can be obtained from a variety of free internet sources (e.g. <http://www.oanda.com/currency/converter/>).

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