11 Raven Wharf, Lafone Street, London, SE1 2LR Tel: +44 (0)20 7403 5959 Fax: +44 (0)20 7403 3111
Email: gba@greenback-alan.co.uk Web: www.greenback-alan.co.uk

Published in The Daily NNA, UK & EU and Germany
May 2007

The EU Treaty and Taxation

The EU treaty is playing an increasingly important role in the taxation of businesses resident in Member States. In particular the principles enshrined under the freedom of establishment and free movement of capital provisions have caused numerous difficulties for policy makers in relation to domestic tax laws that have historically discriminated against businesses established in other jurisdictions. The application of these principles is having a significant affect on the financing and holding arrangements of EU companies. This article is intended to provide a brief summary of financing issues within the EU and the way the EU treaty is impinging on these decisions.

One of the most recent rulings in relation to company financing was in the 'Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue' case which decided against the UK tax authority. In 2004 the UK amended its transfer pricing rules to bring them into line with EU law. Before that date, under UK law where HMRC regarded a company to be excessively financed by debt, they could restrict the deductibility of the interest charges against the profits of the thinly capitalised company if the loan is from outside the UK.

The judgement in this case revealed that such treatment was discriminatory and breached the principles of freedom of establishment and free movement of capital. It serves as a warning to domestic governments that they must consider EU law in relation to policy decisions that previously could have been taken on an insular basis.

This also opens up planning and structuring questions for non-EU resident companies that have, or are intending to establish, a presence in the EU, particularly in relation to the financing of those companies. Importantly, the same protections that EU resident companies are entitled to are not afforded to non-EU resident companies. Therefore, non-EU companies looking to establish a presence in the EU may be well advised to do so through a holding company in a suitable jurisdiction to provide financing to further subsidiaries to ensure the optimum tax position is reached.

There are also further areas where the freedom of establishment principle has clashed with domestic laws in relation to outbound dividends. In January 2007, Belgium, Italy, Spain, the Netherlands and Portugal were all referred to the European Court of Justice over their treatment of certain outbound dividends and Latvia was formally asked to end its discriminatory taxation of such dividends. The EU Taxation and Customs Commissioner said at the time that, "The Member States cannot tax dividends paid to companies of other Member States more heavily than dividends paid to their own companies."

The above is only a summary and is not intended to be relied upon as constituting tax advice. No liability can be accepted by the author or Greenback Alan LLP for an act, or omission to act, based on this article.

11 Raven Wharf, Lafone Street, London, SE1 2LR Tel: +44 (0)20 7403 5959 Fax: +44 (0)20 7403 3111
Email: gba@greenback-alan.co.uk Web: www.greenback-alan.co.uk

Published in The Daily NNA, UK & EU and Germany
May 2007

The tax rules of Belgium, Italy, Spain, Latvia, the Netherlands and Portugal may in certain cases lead to higher taxation of outbound dividends than of domestic dividends. While they provide for no or only very low taxation of domestic dividends, outbound dividends are subject to withholding taxes ranging from 5% to 25%.

It seems therefore, that within the EU the corporate tax landscape is being remodelled with a clear distinction between the treatment of EU resident businesses and non EU resident businesses. Those businesses within the EU are likely to achieve significantly greater protections than non-EU businesses in terms of financing and outbound dividends where the companies involved represent more than simply a financing conduit. The recent Cadbury Schweppes decision in relation to the UK's controlled foreign company rules has made clear that where arrangements are entered into that are wholly artificial the same protections may not be available however, so it is important that there is genuine substance to any holding company arrangements entered into. For many businesses Cyprus, with its network of treaties and absence of withholding on outbound interest, dividend and royalty payments has become a gateway to the EU.

What seems clear however is that the EU treaty will play an increasingly important role in the domestic taxation affairs of Member States and as a consequence companies transacting business in the EU need to conduct their affairs in a way that makes maximum use of the opportunities available.

The above is only a summary and is not intended to be relied upon as constituting tax advice. No liability can be accepted by the author or Greenback Alan LLP for an act, or omission to act, based on this article.