MONTHLY FEATURES

EC Tax Scene

Tax Package Finally Adopted; Substantial Modification of Interest and Royalty Directive

The European Commission has welcomed the Council's adoption of a package of three measures to tackle harmful tax competition. The Commission proposed the package in October 1997 and the Council has been continuing discussions since then on the basis of an outline that it agreed to in December 1997. The tax package consists of a Council Directive to ensure effective taxation of interest income from the cross-border investment of savings that is paid to individuals within the EU, a Code of Conduct for business taxation, and a Council Directive to eliminate withholding taxes on payments of interest and royalties between associated companies of different Member States. Member States agreed in 1997 that this package was necessary to help achieve certain objectives, such as reducing the continuing distortions in the Internal Market, preventing excessive losses of tax revenue, and restructuring tax systems in a more employment friendly direction. The Savings Tax Directive is due to take effect from 1 January 2005, and the Interest and Royalties Directive from 1 January 2004.

The text of the Interest and Royalties Directive has been substantially modified from its original form. The final version removes the provision (Art. 7) whereby no withholding tax would be levied if payments were subject to low/no taxation in the hands of the recipient. This provision was originally introduced to ensure that interest and royalty payments were subject to tax at least one time in one of the Member States. The Article would have allowed a Member State to levy (additional) taxes under certain conditions, up to the level of taxation in the state of receipt. Member States would not have been able to levy (additional) taxes solely if they were of the opinion that the other Member State levied substantially lower taxes or no taxes at all. Article 7 was removed because it appeared to be unnecessary after adoption of the entire tax package, which includes the Code of Conduct on business taxation that requires Member States to eliminate harmful tax measures, such as low tax regimes. The removal of Art.icle 7, therefore, favours countries such as Ireland and, in the future, Cyprus.

Belgian Court holds participation exemption incompatible with EC Parent-Subsidiary Directive

Under Belgian tax law, dividends that qualify for the participation exemption are first included in profits. Subsequently, 95 per cent of the dividends are deducted, but the dividends are not deductible from certain expenses. If the amount of the exempt dividends is greater than the remaining taxable base, the excess qualifying dividends cannot be deducted and the exemption cannot be carried forward.

The Belgian Court of Appeal has held that the participation exemption restricts the exemption of dividends received to the taxable base after certain deductions of other costs, which adds additional requirements that are not included in the EC Parent-Subsidiary Directive. This results in the partial double taxation of the dividends received. Furthermore, the possibility to carry forward losses is reduced if dividends that qualify for the participation exemption are received. The Court held that if the profits realized are less than the dividends exempt under the participation exemption, the difference between the amounts giving rise to a loss can be carried forward. The Court did not rule on the compatibility of the provision with the freedom of establishment provision in the EC Treaty and did not request a preliminary ruling from the ECJ.

Belgian tax regime for US Foreign Sales Corporations (FSC) not in line with EU state aid rules

The European Commission announced on 24 June 2003 that the Belgian tax regime governing US FSCs located in Belgium is illegal state aid under EU rules but it has not ordered recovery of the aid.

Under the Belgian scheme, a FSC in Belgium can obtain a special tax ruling relating to its business activities with a view to determining the amount of taxable profits with respect to its operations with related foreign companies. A FSC's taxable profits are determined by applying a fixed 8 per cent mark-up to certain qualifying costs incurred by the FSC. Qualifying costs do not include direct costs relating to advertising, sales promotion, carriage of goods and credit risks. The scheme only applies to Belgian subsidiaries or establishments of FSCs operating within a multinational group of companies, provided that the FSCs have obtained a special ruling from the Belgian tax authorities.

The Commission has concluded that the features of the Belgian FSC scheme are similar to those of Belgian coordination centres. Since the Belgian coordination centres regime was considered in 1984 not to involve

state aid, the Commission has now concluded that the Belgian authorities and the beneficiaries of the Belgian FSC regime were entitled to rely on legitimate expectations that the regime did not constitute state aid at the time it was implemented. Therefore, the Commission has not ordered recovery of the aid. Taking into account Belgium's voluntary phasing out of the effects of the regime following the repeal of US FSC legislation in September 2000, the Commission has asked Belgium to repeal the scheme by the end of the current fiscal year.

Otmar Thoemmes,
Deloitte & Touche Munich, Germany,
and Hans van den Hurk,
Deloitte & Touche Eindhoven, The Netherlands

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