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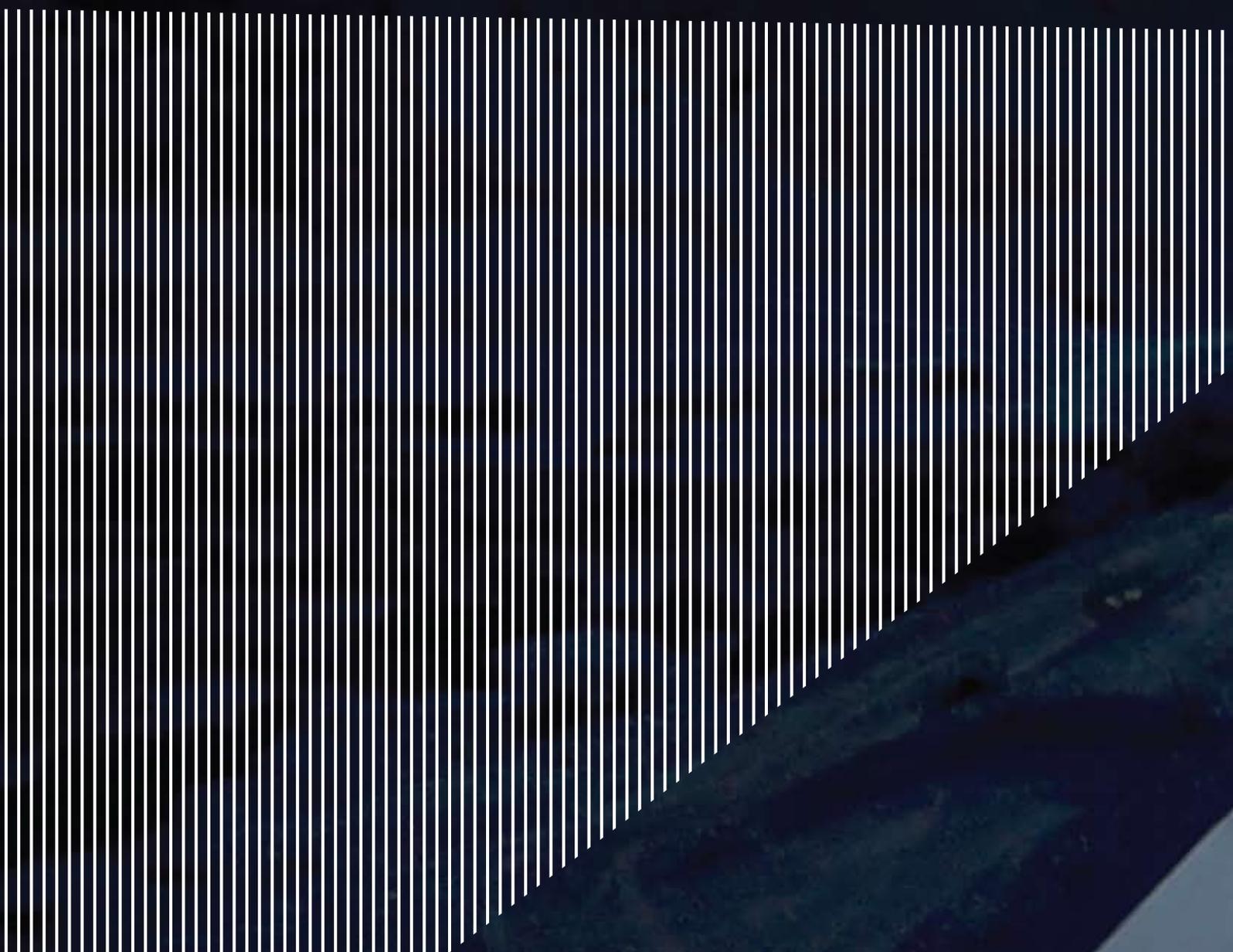
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Trading in the European Union (EU) is crucial to global business success for many multinational enterprises. But managing the impact of European law on 27 countries' different tax systems can prove a daunting challenge. Our EU tax professionals are based in every member state. Their insights and experience help you build proactive and integrated tax strategies that address EU tax opportunities and risks. It's how Ernst & Young makes a difference.

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Implementation of the amended Parent-Subsidiary Directive

A study covering the 27 European Union
Member States



Knowing how the payment of cross-border dividends will be taxed in the European Union (EU) is crucial for your multinational organization, both for tax compliance purposes and for effective tax planning and international structuring. But with 27 Member States in the EU, it can be difficult to keep track of each country's requirements. Does tax apply to cross-border dividends? If there's an exemption, who qualifies? Does the answer depend on the companies' activities or legal form? Does it depend on where you base your operations? Are each country's local rules in line with EU law? Or are they open to challenge?

At first glance, the tax treatment of dividends paid between related EU companies seems relatively simple. The EU Parent-Subsidiary Directive (PSD)¹ provides for tax exemption for cross-border dividends paid between related companies located in different Member States. Member States are obliged to put the PSD into practice through their national laws, so that companies based in the EU's single market of 27 Member States can operate on an equal footing, regardless of where they are established.

¹Council Directive 90/435/EEC, as amended by Council Directive 2003/123/EC.



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Look closely and the reality is more complicated

Although the PSD sets out a blueprint for the tax treatment of cross-border dividends, its provisions are not applied automatically in the same way in each country's national laws. Crucial differences apply between Member States, both in the qualifying conditions for exemption and in the practical application of the rules.

Some of these differences arise because each Member State has its own tax and legal systems. Other differences arise because some Member States have introduced restrictive conditions or anti-avoidance provisions to prevent abuse, which may – or may not – be in line with EU law. In practice, the scope of the exemption can vary greatly between Member States, with important consequences for investment decisions and tax compliance processes.

To help our multinational clients operate effectively within the European Union, we conducted a survey into the current implementation of the PSD in the 27 EU Member States, using Ernst & Young's network of EU Tax professionals.

Our PSD survey provides:

- ▶ A comparison of implementation of the PSD and anti-abuse and other provisions across the 27 Member States
- ▶ A brief overview of the different anti-abuse provisions that apply in each EU Member State, including the "business purpose" and "substance" requirements applied in each Member State
- ▶ A high-level overview for potential EU investors considering investments in another Member State

- ▶ Indications in each Member State of the interpretation of the relevant European Court of Justice (ECJ) jurisprudence with respect to anti-abuse rules, with comments about the possible incompatibility of national anti-abuse provisions with EU law
- ▶ Identification of other national provisions that may be contrary to the PSD

The survey provides useful information and guidance about how the PSD is implemented in each Member State as of June 2009. The individual country reports also highlight possible infringements of EU law arising from domestic legislation. Article 11 of the PSD, for example, allows Member States to establish national anti-abuse provisions, but these provisions are only valid if they are in line with the principles of EU law and the jurisprudence of the ECJ, as stipulated in the Cadbury Schweppes decision² and other relevant cases. These differences are important, as domestic rules that do not conform to EU law may be open to challenge by taxpayers.

²Case 196/04 Cadbury Schweppes, 2 May 2006.



Our survey reported that all 27 EU Member States have now adopted the PSD into their national tax laws. However, differences in implementation of the PSD participation exemption do apply between different countries. Domestic rules that do not conform to EU law may be open to challenge by taxpayers.

The PSD – the EU legal background

The PSD³ sets out the common system of EU taxation for parent companies and subsidiaries based in different Member States. It was originally adopted in 1990. The 1990 PSD was designed to eliminate tax obstacles related to profit distributions between groups of companies in the EU by:

- ▶ Abolishing withholding taxes on payments of dividends between associated companies of different Member States
- ▶ Preventing double taxation of parent companies on the profits of their subsidiaries

On 22 December 2003, the Council of the EU adopted an amendment to the original PSD⁴ in order to broaden its scope and improve its operation, based on recommendations made by the EU Commission on 8 September 2003. The 2003 amendment contained three main elements that:

1. Updated the list of companies covered by the PSD
2. Relaxed the conditions for exempting dividends from withholding tax (i.e., a reduction in the participation threshold)
3. Eliminated double taxation for subsidiaries of subsidiary companies

The then-existing 15 EU Member States were obliged to ensure that the national legislation required to implement the amended PSD was in force by 31 December 2004 at the latest. The 1990 PSD also applied to the 10 new

Member States (known at the time as the “Accession Countries”) that joined the EU on 1 May 2004, as no transitional provisions were provided in the accession negotiations to delay or modify the implementation of the PSD in the new Member States. The 2003 amendment to the PSD applied to the Accession Countries with effect from 1 January 2005. Subsequently, the amended PSD also applied to the two additional Member States, Bulgaria and Romania, which joined the EU on 1 January 2007, with effect from that date.

State of implementation of the PSD in the 27 EU Member States

Our survey reported that all 27 EU Member States have now adopted the PSD into their national tax laws. However, differences in implementation of the PSD participation exemption do apply between different countries. These differences are listed in detail in the individual country reports that make up this publication, and we outline some of the main differences prior to the country reports section.

It is important that companies who pay or receive cross-border dividends in the EU are aware of these differences in the application of the PSD according to the national legislation in the 27 Member States, not only to comply with their obligations, but also to operate tax-effectively in the EU. Some of the differences identified by our survey relate to legislative options or to the application of anti-abuse legislation, as permitted by EU law.

³Council Directive 90/435/EEC.

⁴Council Directive 2003/123/EC.

However, some of the differences cited restrict the effective application of the PSD by, for example, applying additional criteria not provided for in the PSD. These national provisions are potentially in contravention of EU law and, therefore, may be open to challenge.

Examples of differences in implementation include the following:

- ▶ The Czech Republic and Finland have decided not to implement Article 4 paragraph (1a) PSD (the “transparent entity” principle)
- ▶ Many Member States actually apply less restrictive requirements for accessing the PSD participation exemption regime with respect to the minimum holding period requirement or the minimum shareholding requirement than are provided in the PSD itself. This list includes (but is not restricted to) Bulgaria, Finland, Ireland, Latvia, Luxembourg and the Netherlands

Anti-abuse provisions related to the PSD

The EU permits individual Member States to introduce certain provisions into national legislation to prevent abuse of the PSD. However, any domestic anti-abuse provisions must be permitted by the PSD and must conform to the general principles of EU law, such as proportionality and nondiscrimination. A number of EU Member States have introduced anti-abuse provisions related to the application of the PSD, and these domestic anti-abuse provisions account, to a large extent, for the differences in application in the individual Member States.

Anti-abuse measures for inbound dividends (dividends paid to a domestic shareholder company by another EU subsidiary)

Currently, 12 Member States have adopted anti-abuse regulations in their national tax provisions relating to dividends paid to a domestic shareholder company by another EU subsidiary (“inbound” dividends). In addition, the **United Kingdom** intends to introduce tax avoidance rules in the course of the proposed implementation of the new “Taxation of Foreign Profits” legislation following the ECJ decision in the Franked Investment Income GLO (FII GLO) case.⁵ Under the proposals, the UK’s current credit system for inbound dividends is to be replaced by a dividend exemption regime (which already applies to domestic distributions in the UK).

The “abuse of law” principle is interpreted differently by different Member States. For example, some Member States apply a quite broad definition of the principle with respect to purely artificial arrangements (**France** and **Denmark**) or require some kind of entity resemblance test (**Sweden**).

Specific anti-abuse provisions and interpretations identified by the survey include:

- ▶ **Austria:** In the case of any abuse of the PSD, there is a switch from the exemption method to the credit method. Abuse is assumed if the subsidiary is located in a “tax haven” (i.e., a country with a corporate tax rate, according to Austrian standards of tax calculation, which is not higher than 15%) and derives mainly passive income (i.e., interest, royalties, capital

⁵Case C446/04, 12 December 2006.



A few countries define abusive behavior as having investments in “passive” or “low-taxed” (or both) foreign corporations (Austria, Cyprus, Hungary, Netherlands and Spain). However, the definitions of what constitute “low taxation” or “passive” investments differ in each Member State.

gains). The Austrian company is authorized to credit the foreign corporate income tax and withholding tax paid by the subsidiary relating to the dividend.

- ▶ **France:** The French tax authority’s Administrative Guidelines define “abuse of law” as applying if “the set up of the intermediary subsidiary is purely fictitious or its sole purpose is to transform revenues that would have been subject to normal taxation in France into dividends benefiting from the exemption.”
- ▶ **Denmark:** The PSD (or a Double Taxation Agreement) does not apply if the foreign company distributing the dividend to the Danish company is merely a “pass-through” company (i.e., it just receives dividends and immediately distributes them to its Danish parent company). However, only limited guidelines are available defining exactly what the concept of a “pass-through” company means and no tax rulings or case law exist yet on this issue. It is likely that the concept is to be interpreted in line with the “beneficial ownership” concept in Denmark’s Double Taxation Agreements. However, the possibility cannot be excluded that the PSD concept is wider and applies to more situations.
- ▶ **Sweden:** From a Swedish tax perspective, the shares in the foreign subsidiary must be considered to be a “business-related holding.” Shares held in a company resident in an EU Member State are always considered to be held for “business purposes” (even if they are held as current assets) if the company holding the shares holds 10% or more of the share capital.

However, in order to be considered a “business-related holding,” the foreign subsidiary must also be equivalent to a Swedish company. In practice, this condition may not present a major issue as a foreign corporation is always considered to be equivalent to a Swedish company if it is resident and liable for income tax in a country with which Sweden has entered into a Double Taxation Agreement, providing taxation is not limited to certain income and the entity is covered by the provisions of the Double Taxation Agreement. However, in certain situations, the Swedish provision could be regarded as a restriction not permitted under the PSD.

A few countries define abusive behavior as having investments in “passive” or “low-taxed” (or both) foreign corporations (**Austria, Cyprus, Hungary, Netherlands and Spain**). However, the definitions of what constitute “low taxation” or “passive” investments differ in each Member State. Exemptions might apply in cases, for example, where the low-taxed passive subsidiary is resident in the EU or in a country that is a member of the Organisation for Economic Co-operation and Development (OECD), or in a country which has a Double Taxation Agreement in force with the parent company’s state of residence (**Hungary and Spain**). **The Netherlands** applies a “switchover” system from exemption to the credit method for low-taxed and nonactive participations. **Spain and Cyprus** apply a tax credit system for foreign dividends that do not fall under the PSD (which, in the case of Spain, includes a credit for the underlying tax paid by the subsidiary in its country of residence).

In addition, some countries assume abusive behavior if inbound dividends are received from a resident corporation located in a country listed on a local “blacklist” of tax haven countries (Slovenia and Spain).

Finally, some Member States apply certain other restrictions or require further conditions to be met. Specific examples include:

- ▶ **Belgium:** The foreign shareholding must qualify as a “financial fixed asset” under Belgian GAAP. Belgium also applies a restrictive interpretation of the one-year minimum shareholding period (the share-for-share approach) and the “subject to tax” condition.
- ▶ **Greece:** The shareholding must have been held for a minimum two-year shareholding period at the time of the distribution, contrary to the verdict in the Denkavit case,⁶ in which the ECJ decided that the holding requirement may be fulfilled following the dividend distribution.
- ▶ **Latvia and Spain:** Proof is required of the EU residency of the payer of the dividend and, in Latvia, evidence of its eligibility for the PSD must be explicitly provided to the tax authority.

Anti-abuse measures related to outbound dividends (dividends paid by a domestic company to a foreign shareholder)

Anti-abuse provisions may also apply to dividends paid by a domestic company to a foreign shareholder (“outbound” dividends).

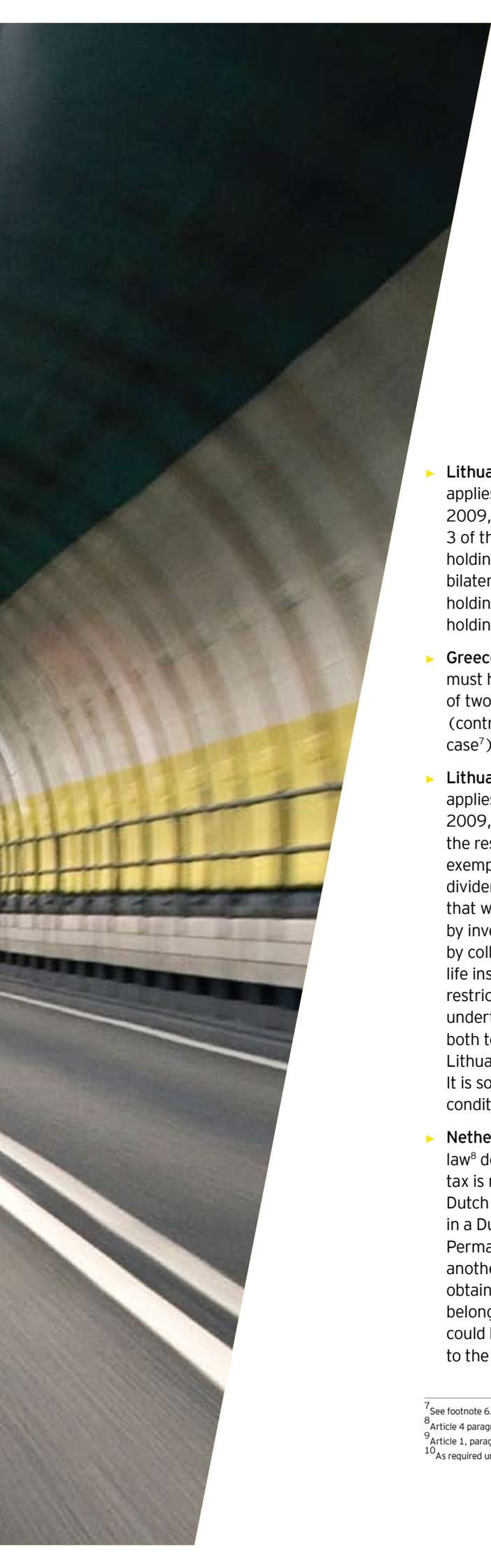
Some Member States, for example, apply so-called “anti-treaty-shopping provisions” to restrict access to the PSD (Austria, Denmark, France, Germany, Ireland, Malta and Spain). These provisions are generally aimed at ensuring that the EU parent shareholder is established for true business reasons and is not a mere shell company established in an EU country by non-EU residents primarily to derive benefits from the application of the PSD. The individual provisions differ from country to country; however, in most cases, the foreign parent company must provide proof of sufficient substance in its EU Member State of residence and/or it must demonstrate that it is established for true business purposes.

In addition, some EU Member States apply certain other restrictions or require further conditions to be met. Examples include:

- ▶ **France:** In order to benefit from the withholding tax exemption on dividends, the foreign parent company must hold directly 10% or more of the financial and voting rights of the distributing company for at least two years without interruption. The French financial and voting rights requirement may be regarded as contrary to the PSD, since Article 3 of the PSD only requires a capital holding and it allows Member States to bilaterally agree to replace the capital holding requirement by a voting rights holding requirement.
- ▶ **Greece:** The shareholding participation must have been held for a minimum of two years at the time of distribution (contrary to the verdict in the Denkavit case⁷).

⁶Case C-283/94, ECR 1996, P.I-5063, 17 October 1996.



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- ▶ **Lithuania:** The participation exemption applies with effect from 1 January 2009, with certain PSD, since Article 3 of the PSD only requires a capital holding and it allows Member States to bilaterally agree to replace the capital holding requirement by a voting rights holding requirement.
 - ▶ **Greece:** The shareholding participation must have been held for a minimum of two years at the time of distribution (contrary to the verdict in the *Denkavit* case⁷).
 - ▶ **Lithuania:** The participation exemption applies with effect from 1 January 2009, with certain restrictions. Under the restrictions, the participation exemption rule does not apply to dividends distributed from profits that were tax-exempt, profits reduced by investment reliefs, profits earned by collective investment vehicles or life insurance premiums with some restrictions received by insurance undertakings. This provision applies both to dividend payments made to Lithuanian and to foreign residents. It is somewhat unclear whether these conditions are contrary to the PSD.
 - ▶ **Netherlands:** Dutch withholding tax law⁸ does not require that withheld tax is refunded in the case of a Dutch company holding the shares in a Dutch subsidiary through a Permanent Establishment (PE) in another EU country as, in order to obtain a refund, the shares must belong to a Dutch enterprise. This rule could be considered to be contrary to the PSD.⁹ In addition, the Dutch

withholding tax law contains a legal form requirement, which requires that only those entities listed in the PSD can apply for the exemption. Although the PSD has the same requirement regarding legal form in order to apply for the exemption, this requirement in the Dutch withholding tax law could be considered against the nondiscrimination principle of EU law, as this requirement does not apply in a purely domestic situation.

- ▶ **Austria:** The withholding tax exemption requires that the EU parent company directly holds a minimum of 10% for a period of one year. According to a ruling of the Ministry of Finance, indirect ownership by an EU parent company via an EU partnership should also be sufficient.

Finally, some EU Member States have explicitly introduced documentation or information requirements for proving the tax residency status of the foreign shareholder company, the determination of the beneficial owner of the dividends or the actual qualification of the corporate shareholder as a "company of a Member State"¹⁰ (**Cyprus, Czech Republic, Latvia, Portugal, Slovenia and Poland**). It could be argued that these anti-abuse measures are not proportional if, for example, the participation exemption is denied due to a lack of documentation even though it is clear that the corporate shareholder is a resident of the EU or the European Economic Area (EEA) that fulfills the conditions set by the PSD (**Poland**).

⁷ See footnote 6.

⁸ Article 4 paragraph 1 PSD, as implemented in connection with Article 10, paragraph 2 of the Dutch Withholding Tax legislation.

⁹ Article 1, paragraph 1, fourth point of the Dutch Withholding Tax legislation in connection with Article 5 PSD.

¹⁰ As required under Article 2 PSD.



Austria	Belgium	Bulgaria	Cyprus	Czech Republic	Denmark	Estonia	Finland	France
Germany	Greece	Hungary	Ireland	Italy	Latvia	Lithuania	Luxembourg	Malta
Netherlands	Poland	Portugal	Romania	Slovak Republic	Slovenia	Spain	Sweden	United Kingdom



Implementation of the amended PSD in the 27 EU Member States

Domestic tax regulations for inbound and outbound dividends

Austria

Is the amended PSD implemented in full?

In general, the provisions of the PSD have been implemented in Austria

Outbound dividends

No withholding tax is withheld in Austria if the following conditions are met:

- ▶ The EU parent company is listed in the Annex to the PSD.
- ▶ The parent company directly holds at least 10% of the shares in the subsidiary for more than one year.
- ▶ There is no abuse.
- ▶ The EU parent company must provide written confirmation that it has an office space, employees and an operational activity.

According to the Austrian Ministry of Finance, no withholding tax should be withheld in Austria (subject to the conditions above) if the EU parent company holds its shares indirectly via an EU partnership.

Inbound dividends

An Austrian company is entitled to benefit from the international participation exemption if the following conditions are met:

- ▶ It holds at least 10% of the share capital of a foreign corporation that is comparable to an Austrian corporation.

- ▶ The shares have been held for more than one year.
- ▶ There is no abuse.

In the case of abuse, there is a switch from the exemption method to the credit method. The Austrian company is authorized to credit the foreign corporate income tax and withholding tax paid by the subsidiary relating to the dividend.

There is an ECJ decision pending on the following issue: dividends from a domestic shareholding in an Austrian company are tax-free, without a minimum holding requirement. Thus, there is currently discrimination against EU and international dividends in respect of the minimum holding period and the holding percentage required, compared with domestic dividends. The Austrian Supreme Court has already ruled that the nonexemption of international portfolio dividends is discriminatory under EU law.¹¹ However, the court decided that there would be no discrimination if, instead of an exemption, the underlying taxes (corporate income tax and withholding tax) were credited to the Austrian corporate income tax on the dividends. The appellate court referred the case to the ECJ asking whether the proposed credit system (instead of an exemption) could still constitute a violation of EU law.¹²

According to a legal amendment, portfolio dividends from EU and EEA companies will also benefit from the participation exemption in Austria. The law is currently passing the legislative process.

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¹¹ VwGH 2008/15/0064, 17 April 2008.

¹² UFS RV/0611-L/05, 29 September 2008.

Belgium

Is the amended PSD implemented in full?

Yes.

Outbound dividends

The withholding tax exemption as provided for in Belgian tax law is in line with the PSD. No additional conditions that are not provided for in the PSD are imposed under Belgian law.

Inbound dividends

Under the Belgian participation exemption, inbound dividends (domestic and foreign) are included in the taxable basis and are subsequently deducted for 95%.

The participation exemption applies to the extent that the company's taxable basis is positive. If a company incurs losses or realizes insufficient taxable income, the excess participation exemption cannot be carried forward. The ECJ has confirmed that the Belgian participation exemption regime is contrary to the PSD in this regard with respect to EU dividends.¹³

Also, in order for the participation exemption to apply, several conditions need to be met. Conditions that may be contrary to the PSD include the following:

- ▶ The shares must qualify as "financial fixed assets" under Belgian GAAP.
- ▶ The shares have been (or will be) held during an uninterrupted period of at least one year.

According to the preparatory works to the law introducing this condition, the one-year holding requirement should be met for each share separately, regardless of the fact that the overall minimum participation threshold has been met.

- ▶ The "subject to tax" condition contains several tests that need to be met, some of which may be contrary to the PSD.

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¹³ Case C-138/07 Cobelfret, 12 February 2009. The Belgian government announced a carryover provision for excess participation exemption with respect to EU dividends, in order to be in line with the ECJ decision. A circular letter has been drafted by the Belgian Minister of Finance on this issue and will be published shortly.

Bulgaria

Is the amended PSD implemented in full?

The PSD was implemented into the Bulgarian Corporate Income Tax Act (CITA) with effect from 1 January 2007 (the date of Bulgaria's accession to the EU). Further amendments were introduced with effect from 1 January 2009 that provide for a more flexible regime regarding dividend withholding than that stipulated in the PSD. Under the latest amendments to the CITA, dividends paid to a legal entity that is tax resident in an EU or EEA Member State are exempt from withholding taxation. No restrictions apply as to the legal form of the legal entity (i.e., no reference is made to Appendix 1 PSD, no conditions apply to the income of the recipient, nor is there a minimum holding period for the parent under the current provisions of the CITA). Moreover, there is no specific administrative procedure required for the implementation of the provisions.

Outbound dividends

Dividends payable to a legal entity that is tax resident in an EU or EEA Member State are not subject to withholding taxation in Bulgaria.

Inbound dividends

Dividends received from an offshore company are exempt from corporate taxation in Bulgaria (i.e., these dividends

are excluded from the tax base of the Bulgarian company for corporate income tax purposes, regardless of where the company is located and regardless of the percentage held in its share capital).

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Cyprus

Is the amended PSD implemented in full?

Yes.

Outbound dividends

In principle, dividends paid by a Cypriot tax resident company to a nonresident corporate shareholder are not subject to any withholding tax in Cyprus.

However, if, within two years from the end of the financial year, a Cypriot tax resident company does not distribute at least 70% of its after-tax accounting profits (excluding revaluations and fair value adjustments), there is a deemed distribution of 70% of the profits (reduced by any actual distributions made) and defence tax at a rate of 15% is payable to the Cypriot tax authority (under the deemed dividend distribution rules).

These rules are applied regardless of whether the shareholders are companies or individuals.

The deemed dividend distribution rules are, however, not applied if the shareholders are nonresidents, except to the extent that the shares of the company are held by another Cypriot resident company whose shares are held by nonresidents. In addition, in this latter case, any defence tax payable as a result of a deemed dividend distribution that relates to dividends received by a nonresident is, in principle, refundable.

To ascertain the tax residency of shareholders for the refund of defence

tax, a nonresident shareholder must complete and submit a questionnaire to the paying company declaring its tax residency status, which must be forwarded to the Cypriot tax authority.

Inbound dividends

The Cypriot (corporate) income tax and defence tax rules are in accordance with the PSD.

Dividends received by a company resident in Cyprus from nonresident companies are exempt from Cypriot (corporate) income tax.

Dividends received from a nonresident company by a Cypriot tax resident company are also exempt from Cypriot defence tax, provided the participation in the share capital of the company is at least 1%.

However, this defence tax exemption does not apply if more than 50% of the income of the dividend-paying company is derived (directly or indirectly) from investment activities and the profits of the dividend-paying company have been effectively taxed at less than 5%. In that case, the dividends received are subject to 15% defence tax.

It should be noted that only one of these two tests needs to be met for the exemption to apply.

Any foreign tax withheld from a dividend is given as a tax credit against the defence tax payable in Cyprus.

In accordance with Cypriot income tax law, if a company that is tax-resident in Cyprus receives dividends from a company that is resident in another Member State, and the dividends are subject to tax in Cyprus, the tax paid on the dividends in the other EU Member State is granted as a credit against the tax payable in Cyprus. This tax includes a proportion of tax on the profits of the company paying the dividend and of any of its subsidiaries from which the dividend arises.

Although the first schedule of the (corporate) income tax law does not explicitly list entities belonging to the two most recent EU Member States (Bulgaria and Romania), the definition of a company under the Cypriot law includes every company "with or without legal personality" and, therefore, it also applies to entities from those countries. However, the list should be updated to include Bulgarian and Romanian entities explicitly.

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Czech Republic

Is the amended PSD implemented in full?

Yes, except for Article 4 (1a) PSD.

The minimum holding percentage for a qualifying parent company in a qualifying subsidiary is 10%.

The tax exemption method applies.

In addition, the PSD tax exemption as implemented in the Czech tax law (the Czech PSD exemption) applies to:

- ▶ Dividends distributed from a qualified Czech subsidiary to a Swiss, Norwegian or Icelandic company, provided the PSD conditions, as implemented in the Czech tax law, are met
- ▶ Dividends received by a Czech company from a qualified Norwegian or Icelandic subsidiary, provided the PSD conditions, as implemented in the Czech tax law, are met

Outbound dividends

If a qualified Czech subsidiary is liquidated and distributes dividends to an EU parent company, the Czech PSD applies (previously, there was a discrepancy with the PSD in this regard; however, it has been corrected with effect from 2009). If a qualified Czech subsidiary is liquidated and distributes dividends to a qualified Czech parent company, the Czech PSD exemption does not apply.

The Czech PSD exemption applies only if the recipient of the dividend is the beneficial owner. The Czech tax

law defines a “beneficial owner” as a taxpayer that receives payments for its own benefit and not as an intermediary, agent or fiduciary. In practice, based on a nonbinding instruction issued by the Ministry of Finance, it is recommended that the following documents are made available to the payer of the dividend:

- ▶ A tax residency certificate confirming the tax residency status of the parent company, issued by the relevant tax authority
- ▶ A beneficial owner declaration
- ▶ Other legal documents proving fulfillment of the other Czech PSD conditions (e.g., ownership of at least 10% of the registered capital)

Inbound dividends

Please see the outbound dividends column comments on the “beneficial ownership” requirement.

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Denmark

Is the amended PSD implemented in full?

Yes.

Outbound dividends

It is unclear to what extent the PSD allows for specific anti-abuse provisions. The Danish Tax Minister has stipulated that the PSD (or Double Taxation Agreement) does not apply if the foreign company receiving the dividend is merely a “pass-through” company that just receives dividends and immediately distributes them to its foreign parent company. The “pass-through” company is considered a nullity and the dividend is considered to be distributed by the Danish company directly to the foreign company’s parent company.

This provision is difficult to interpret in practice as only limited guidelines on the concept of “passing-through” are available and no tax practice yet exists in this area. However, it is likely that the concept should be interpreted in line with the “beneficial ownership” concept provided for in Denmark’s Double Taxation Agreements, but the possibility cannot be excluded that the PSD “pass-through” concept may be wider and may cover more situations.

Inbound dividends

It is unclear to what extent the PSD allows for specific anti-abuse provisions. The Danish Tax Minister has stipulated that

the PSD (or Double Taxation Agreement) does not apply if the foreign company distributing the dividend to the Danish company is merely a “pass-through” company that just receives dividends and immediately distributes them to its Danish parent company. The “pass-through” company is considered a nullity and the dividend is considered to be received by the Danish company directly from the “pass-through” company’s subsidiary.

This provision is difficult to interpret in practice as only limited guidelines on the concept of “passing-through” are available and no tax practice yet exists in this area. However, it is likely that the concept should be interpreted in line with the “beneficial ownership” concept provided for in Denmark’s Double Taxation Agreements, but the possibility cannot be excluded that the PSD “pass-through” concept may be wider and may cover more situations.

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Estonia

Is the amended PSD implemented in full?

A transitional period for the implementation of the PSD applied until 1 January 2009.

Subsequent to the ECJ Burda¹⁴ decision, no changes in Estonian corporate taxation were considered necessary with effect from 1 January 2009.

Outbound dividends

All outbound dividends are exempt from withholding tax (this also applies to dividends paid to a non-EU company).

Inbound dividends

Full exemption applies to inbound dividends. The Estonian domestic regulations are more liberal than the PSD (e.g., no holding period is required).

From the point of view of "substance," the subsidiary must be resident and subject to corporate taxation in an EU or EEA country or in Switzerland.

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¹⁴Case C-48/06 26 June 2008.

Finland

Is the amended PSD implemented in full?

Yes, except for Article 4 (1a) PSD.

Outbound dividends

No specific conditions apply. No withholding tax is levied if the recipient company is mentioned in the PSD and the foreign payer company owns at least 10% of the dividend distributing company. Also, portfolio dividends are exempt from withholding tax under certain circumstances.

Inbound dividends

No specific conditions apply. No income tax is payable if the dividend distributing company is mentioned in the PSD and the Finnish company owns at least 10% of the dividend distributing company. Also, portfolio dividends are exempt from withholding tax under certain circumstances.

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France

Is the amended PSD implemented in full?

Yes.¹⁵

Outbound dividends

To benefit from the withholding tax exemption on dividends, the foreign parent company must satisfy the following conditions:

- ▶ It must be the beneficial owner of the dividends.
- ▶ It must have its effective place of management located in an EU Member State and it must not be considered to be resident for tax purposes outside the EU under a Double Taxation Agreement concluded with a third country.
- ▶ It must hold directly 10% or more of the financial and voting rights of the distributing company for at least two years without interruption.
- ▶ It must not be directly or indirectly controlled by non-EU legal entities or individuals or, if it is so controlled, it must demonstrate that the chain of participation is not principally aimed at benefiting from the exemption.

The “effective place of management” requirement may be regarded as contrary to the PSD since the PSD applies to dividends distributed to a “company of a Member State,” defined under

Article 2 PSD as a company resident for tax purposes in a Member State according to the tax laws of that Member State.

With regards to the two-year ownership requirement, the law has been amended in order to comply with the 1996 ECJ Denkavit¹⁶ decision, so that the exemption now applies from the date of acquisition of the minimum participation if the parent company commits itself to holding this participation for at least two-years.

The “financial and voting rights” requirement may be regarded as contrary to the PSD since Article 3 PSD only requires a capital holding and it allows EU Member States to bilaterally agree to replace the capital holding by a voting rights holding.

The French tax authority considers that the “beneficial ownership” and “noncontrolled” requirements are in line with Article 1, paragraph 2 PSD.¹⁷

Inbound dividends

Inbound dividends (domestic and foreign) are effectively 95% tax-exempt (with a 5% add-back of nondeductible expenses).¹⁸

However, the French tax authority may challenge the application of this exemption using the “abuse of law”¹⁹ provision in circumstances, if “the set up of the intermediary subsidiary is purely fictitious or its sole purpose is transforming revenues which would have

been subject to normal taxation in France into dividends that benefit from the exemption.”²⁰

The abuse of law provision has been applied by the French courts in the past to exclude the application of the parent-subsidiary regime.²¹

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¹⁵The PSD was implemented by Article 24 Amended Finance Law 1991 (French Tax Code, Section 119 ter), and Article 44 Amended Finance Law 2004.

¹⁶See footnote 6.

¹⁷Administrative Guidelines 4 J 1334, paragraph 53.

¹⁸Under sections 145 and 216 of the French Tax Code.

¹⁹Contained in section L 64 of the French Tax Procedural Code.

²⁰Administrative Guidelines 4 H 2112, paragraph 22.

²¹Cases: Conseil d'Etat, 18 February 2004, Pléiade; Conseil d'Etat, 18 May 2005, SA Sagal; CAA Paris, 17 April 2008, Bazar de l'Hotel de Ville; Conseil d'Etat, 10 December 2008, Andros.

Germany

Is the amended PSD implemented in full?

Yes.

Outbound dividends

German tax law stipulates that a foreign shareholder cannot claim benefits under the PSD if it does not meet the requirements under the German “anti-treaty shopping” rules.

An exemption from withholding tax is only allowed if all of the following criteria are met in the relevant year:

- ▶ The “business purpose” test is satisfied. The interposition of the foreign entity must be justified by a business purpose. The new law stipulates that, in judging the validity of a business reason, facts relating to a shareholder or affiliate of the interposed entity cannot be taken into account. As a consequence, any valid business purpose at the shareholder level is not taken into account. Furthermore, any business reasons that relate to the concerns of an entire multinational group should be disregarded.
- ▶ The “10% gross receipt” test means that more than 10% of the gross receipts of the foreign entity in the year of distribution must stem from the entity’s own business activities. Income derived from the administration or management of assets and income derived from outsourced activities is not taken into account for these purposes.

- ▶ The “substance” test requires that the foreign entity must maintain a commercial business operation and participate in the market. The business operation must be established for the purpose of carrying out that business activity. The administration or management of assets does not qualify as a “business activity” for these purposes.

Withholding tax applies at a rate of 25% on dividends paid to a foreign entity that does not meet the above criteria. The reduction of the withholding tax rate to 15% under the German Tax Act 2009 does not apply in this case.

Inbound dividends

Under German law, inbound dividends (domestic and foreign) are effectively 95% tax-exempt (with a 5% add-back of nondeductible expenses). No further specific conditions apply.

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Greece

Is the amended PSD implemented in full?

Greece has implemented the PSD into its national legislation.²²

Outbound dividends

With effect from 1 January 2009, any distribution of dividends by a Greek *Anonymos Etaireia* (AE) entity (equivalent to a German AG or a Dutch NV) is subject to 10% exhaustive tax withholding unless the provisions of the PSD apply. The conditions are as follows:

- ▶ There must be a 10% minimum shareholding participation.
- ▶ The holding must have been held for a minimum two-year shareholding period at the time of the distribution (contrary to the verdict in the Denkvit case²³).

It should be noted that the 10% exhaustive tax withholding rate is more favorable than the tax withholding provided for in the majority of Double Taxation Agreements that Greece has signed.

Despite the provisions above, the tax-free distribution of profits without any restriction remains for any profit distribution made by a Greek *Etaireia Perirorismenis Efthinis* (EPE) entity (equivalent to a German GmbH or a Dutch BV), even though Greek EPEs are covered by the PSD.²⁴

Inbound dividends

With respect to inbound dividends, Greece applies the credit system with the same conditions as for outbound dividends both for Greek AEs and for EPEs. The conditions are as follows:

- ▶ There must be a 10% minimum shareholding participation.
- ▶ The participation must have been held for a minimum two-year shareholding period at the time of distribution (contrary to the verdict in the Denkvit case²⁵).
- ▶ To prove the amount of tax paid outside of Greece, a relevant certificate issued by a certified auditor (or any other competent authority) in the country where the tax is paid must be available.

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²²Council Directive 90/435 with Law 2578/98 and Council Directive 2003/123 with Law 3453/2006.

²³See footnote 6.

²⁴Since the enactment of Law 3453/2006.

²⁵See footnote 6.

Hungary

Is the amended PSD implemented in full?

The PSD is fully implemented in Hungary with effect from 1 May 2004.

Until 31 December 2005, dividends paid to EU companies were exempt if the requirements of the PSD were met.

With effect from 1 January 2006, dividend withholding tax has been abolished.

Outbound dividends

No withholding tax is applied to dividends paid to EU or non-EU companies, regardless of the percentage of shareholding, holding period or residency.

Inbound dividends

Dividends received from EU and non-EU subsidiaries are tax-exempt in Hungary.

The participation exemption for dividends does not apply to dividends received from a Controlled Foreign Company (CFC).

A company qualifies as a CFC if its legal seat or its foreign branch is located in a country that does not impose corporate income tax or the effective corporate tax rate is less than two-thirds of the statutory Hungarian corporate income tax rate. A company cannot be classified as a CFC if its registered seat, PE or residency is in the EU, in an OECD member country or in a country that has a Double Taxation Agreement with Hungary.

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Ireland

Is the amended PSD implemented in full?

The PSD was implemented in Ireland with effect from 1 January 2004.

Outbound dividends

In practice, access to the PSD is rarely required, due to more beneficial domestic measures.

Irish Dividend Withholding Tax (DWT) should not normally apply to the payment of dividends to an EU company (unless the EU company is controlled by Irish residents) because of a wide domestic exemption.

The DWT exemption under the PSD does not apply to distributions made to a parent company if the majority of voting rights in the parent company are controlled directly or indirectly by persons who are not resident in an EU Member State or territory with which Ireland has signed a Double Taxation Agreement, unless it is shown that the parent company exists for bona fide commercial reasons and does not form part of any arrangement or scheme of which the main purpose (or one of the main purposes) is the avoidance of income tax, corporation tax or capital gains tax.

Inbound dividends

An Irish resident company is subject to corporation tax on dividends received from nonresident companies.

However, the company is granted relief for foreign taxes paid, and the relief is given either unilaterally under Irish domestic rules, by virtue of the PSD or under Double Taxation Agreements entered into with other states.

Under domestic law, a credit for underlying tax can normally only be claimed if a company (or a 50% parent of the company) owns (directly or indirectly) 5% of the ordinary share capital of the company paying the dividend.

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Italy

Is the amended PSD implemented in full?

Italy has implemented the PSD.²⁶ The law applies (retroactively) with effect from 1 January 2005.

Outbound dividends

If the parent company is controlled (directly or indirectly) by a non-EU company, the PSD applies if the parent company can prove that the shareholding in the Italian company is owned for a “true business purpose” (i.e., the PSD cannot apply if the shareholding is owned with the sole or main purpose of benefiting from the PSD regime). This condition appears to be in line with the PSD provisions.

Inbound dividends

No conditions apply under the Italian tax law.

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²⁶ With the enactment of Legislative Decree No. 49, of 6 February 2007.

Latvia

Is the amended PSD implemented in full?

The PSD was implemented into the Latvian domestic tax legislation with effect from 20 December 2004.

Outbound dividends

The Latvian domestic legislation does not specify any additional requirements for outbound dividends that are not stipulated in the PSD.

It should be noted that no holding percentage and no holding period are required according to the Latvian legislation in order to apply the participation exemption. However, the recipient of the dividend must qualify as "a company of a Member State" according to Article 2 PSD, the provisions of which are directly incorporated into the Latvian Law on Corporate Income Tax. Therefore, the recipient of the dividend must provide the payer with a certificate approved by the tax authority in its Member State of residence stating that the recipient qualifies as "a company of a Member State" according to Article 2 PSD. The certificate is valid for five years from the date of issue provided that the company still qualifies as "a company of a Member State."

Inbound dividends

Dividends received by a Latvian company from a company qualifying as "a company of a Member State" according to

Article 2 PSD (which is incorporated into the Latvian Law on Corporate Income Tax) are not subject to taxation in Latvia. However, in order to apply the participation exemption, the recipient of the dividend must submit to the Latvian State Revenue Service a residence certificate for the payer company, approved by the tax authority in its Member State of residence.

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Lithuania

Is the amended PSD implemented in full?

Yes.

Outbound dividends

In general, dividends paid to Lithuanian or foreign entities are taxed with a 20% withholding tax.

A withholding tax rate of 0% applies if the following conditions are met:

- ▶ The holding of voting rights exceeds 10%.
- ▶ The shareholding is held for at least 12 months.

However, the participation exemption is applied with certain restrictions (with effect from 1 January 2009). The participation exemption rule does not apply to dividends distributed from profits that were tax-exempt, profits reduced by the investment relief, profits earned by collective investment vehicles or life insurance premiums with some restrictions received by insurance undertakings. This provision is applied to dividend payments made both to Lithuanian and foreign residents.

It is not clear whether these conditions are in line with the PSD.

Inbound dividends

With effect from 1 January 2009, inbound dividends received from foreign entities are subject to 20% withholding

tax if the dividends are distributed from a tax-exempt profit. The Lithuanian Law on Corporate Income Tax does not specify which tax exemptions may apply to the profits of a foreign entity.

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Luxembourg

Is the amended PSD implemented in full?

It was not necessary to amend Luxembourg's domestic law to implement the PSD, as the provisions of the amended PSD were already in force.

Outbound dividends

Luxembourg's domestic tax law on the participation exemption regime does not impose any conditions that are not set out in the PSD. On the contrary, Luxembourg has, in some cases, applied the participation exemption in a more favorable way than the PSD. For example:

- ▶ Luxembourg does not require the minimum holding period of two years allowed under the PSD. Instead, it applies a holding period of only 12 months.
- ▶ Luxembourg has introduced an alternative holding criterion of an acquisition price amounting to at least €1.2 million (as an alternative to the 10% holding test).
- ▶ In addition, liquidation proceeds distributed by Luxembourg companies are not subject to withholding tax in Luxembourg.

Inbound dividends

The requirements set out in Luxembourg's domestic law for the exemption of inbound dividends are virtually the same as those that must be met regarding the

exemption of withholding tax on outbound dividends. Luxembourg's domestic tax law on the participation exemption regime does not impose any conditions that are not set out in the PSD. On the contrary, Luxembourg has, in some cases, applied the participation exemption in a more favorable way than the PSD. For example:

- ▶ Luxembourg has extended the participation exemption regime to liquidation proceeds as long as the same conditions as those imposed for the exemption of dividends are met.
- ▶ Under Luxembourg law, capital gains are exempt under the same conditions that apply to dividends and liquidation proceeds, with the exception that the alternative holding criterion requires an acquisition price of at least €6 million.

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Malta

Is the amended PSD implemented in full?

Yes.

Outbound dividends

Maltese law does not include any additional conditions other than those contained in the PSD nor does it impose any conditions that may be regarded as contrary to the PSD. However, Malta does apply an anti-avoidance provision for outbound dividends that may not be in line with the PSD.

The exemption contained in Maltese tax law²⁷ applies to:

- ▶ Interest, discounts, premiums or royalties derived by a nonresident, provided that this income is not attributable to a PE of the nonresident in Malta to which the income is effectively connected
- ▶ Gains or profits arising in Malta on a disposal of:
 - ▶ Units in a collective investment scheme
 - ▶ Units linked to the long-term business of insurance and shares or securities in a company (on redemption, cancellation and liquidation) the assets of which do not consist wholly or principally of immovable property in Malta

The application of the exemption is linked to a “beneficial ownership” test. The exemption applies provided that the

beneficial owner of the interest, royalty, gain or profit is a person that is not resident in Malta and that is not owned and controlled by (directly or indirectly) nor acts on behalf of an individual or individuals who are ordinarily resident and domiciled in Malta.

It would appear that this anti-avoidance provision creates a hurdle that does not seem to be compatible with Article 4 PSD.

Inbound dividends

Maltese law does not include any anti-abuse provisions in respect of inbound dividends.

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²⁷ Article 12 (1) (c) (i) and (ii) Income Tax Act.

Netherlands

Is the amended PSD implemented in full?

Yes, the PSD was implemented with effect from 1 January 2005. The Dutch Withholding Tax (WHT) law has been changed with effect from 1 January 2007.

Outbound dividends

Yes. With effect from 1 January 2007, the Dutch WHT law is in accordance with the PSD.²⁸ Initially, there was a one-year holding period requirement combined with the requirement to give security in relation to the nonresident parent. Under the new WHT law, only a 5% shareholding is required to apply for the exemption and there is no holding period requirement or requirements regarding providing certainty. It should be noted, however, that this change in the WHT law with effect from 1 January 2007 is not retroactive.

Some items in the WHT law could be considered not to be in line with the PSD. For example:

- ▶ The Dutch WHT Act²⁹ does not require that the withheld tax is refunded in the situation of a Dutch company holding the shares in a Dutch subsidiary through a PE in another EU country, as the refund conditions require that the shares belong to a Dutch enterprise. This appears contrary to the PSD.³⁰
- ▶ The WHT law contains a “legal form” requirement that only entities listed in

the PSD can apply for the exemption.³¹ Although the PSD has the same requirement regarding legal form and the application of the exemption, this requirement in the Dutch WHT legislation seems to be contrary to the anti-discrimination principles of EU law, as it is not set in a purely domestic situation.

Inbound dividends

The PSD has been fully incorporated into the Dutch participation exemption regime. With effect from 1 January 2007, a switchover system from exemption to a credit method applies in the case of low-taxed and nonactive participations. It is not fully clear whether this switchover regime is in accordance with the PSD and primary law (such as the ECJ Cadbury Schweppes Case³²). Recent case law of the ECJ³³ indicates, however, that the Dutch switchover system is compliant with EU law.

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²⁸ Article 4 of the Dutch Withholding Tax law.

²⁹ Article 4, paragraph 1 PSD in connection with article 10, paragraph 2 of the Dutch Withholding Tax law.

³⁰ Article 1, paragraph 1, fourth point Dutch Withholding Tax Act in connection with Article 5 PSD.

³¹ Article 4 of the Dutch Withholding Tax law.

³² Case 196/04 Cadbury Schweppes, 2 May 2006.

³³ Case 298/05 Columbus Container, 6 December 2007.

Poland

Is the amended PSD implemented in full?

Yes. The current scope of the PSD exemption provided under the Polish tax regulations seems to be generally in line with the PSD (despite some minor mistakes in the legislative drafting). This is the case with effect from 1 January 2007.

The situation was quite different in the period from 2004 to 2006, when various limitations with respect to the subject and object of the PSD protection applied.

Currently, disputes may arise as the Polish tax regulations require that, for the exemption to apply, the person entitled to the dividend is also the recipient of the dividend payment. This limitation may be important, for example, in cases of subrogation or transfer, etc.

Outbound dividends

There are no “business substance” conditions that must be fulfilled to benefit from the PSD treatment.

However, an administrative condition applies. Under the Polish tax regulations, the foreign shareholder may benefit from the exemption provided it has delivered a certificate of residency issued by the relevant tax authority. The term for delivering the certificate is not specified. The law suggests that having a certificate is a *sine qua non* condition that must be fulfilled. Therefore, if the certificate is not provided, even if the taxpayer is an EU or

EEA resident that clearly fulfills the PSD conditions, the exemption may not be applied by the Polish legislation. The same condition applies in the case of a PE: in that case, a specific note issued by the foreign tax authority is required.

It is arguable whether this Polish anti-abuse measure may be viewed as “proportional” under EU legal principles.

Inbound dividends

No “business substance” or other additional conditions that must be fulfilled in order to benefit from PSD treatment for outbound dividends have been enacted into Polish law.

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Portugal

Is the amended PSD implemented in full?

Yes, the PSD is implemented in full.

Outbound dividends

Dividends paid by a Portuguese company to a parent company resident in another EU Member State are exempt from withholding tax on dividends, provided the following requirements are met:

- ▶ The company receiving the dividends holds more than 10% of the Portuguese company paying the dividends, or the acquisition cost of the shares is at least €20 million.
- ▶ The participation is maintained by the shareholder for an uninterrupted period of at least one year.
- ▶ The EU parent company and the Portuguese subsidiary must be resident in the EU and qualify for the purposes of Article 2 PSD.

It should be noted that, in order to benefit from the participation exemption and before any distribution, the parent company should obtain a statement issued by the tax authority attesting its eligibility for the PSD. The statement can be obtained after the distribution, but a penalty up to €2,500 is imposed on the payer entity. There is no official form available that should be used for this statement.

Inbound dividends

Dividends received from a Portuguese or EU subsidiary are fully exempt from tax if the following requirements are met:

- ▶ The Portuguese company receiving the dividends holds more than 10% of the Portuguese or EU company paying the dividends, or the acquisition cost of the shares is at least €20 million.
- ▶ The participation is maintained by the shareholder during an uninterrupted period of at least one year or, if it has been held for less than one year, the shares are held until the one-year holding period is complete.
- ▶ The Portuguese parent company and the subsidiary must be resident in the EU and qualify for the purposes of Article 2 PSD.

A pure holding company (SGPS) is only required to complete the one-year holding period.

If the minimum holding period and percentage are not met, a 50% exemption is available for dividends from Portuguese or EU subsidiaries.

Under the anti-abuse provision, the underlying profits must have been effectively taxed, unless the recipient of the dividends is an SGPS company. Otherwise, only a 50% exemption is available.

It should also be noted that the Portuguese parent company should obtain a statement issued by the subsidiary's tax authority attesting its eligibility for the PSD. There is no official form available that should be used for this statement.

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Romania

Is the amended PSD implemented in full?

Yes. The PSD was implemented into the Romanian Fiscal Code with effect from 1 January 2007 (i.e., the date of Romania's accession to the EU). The provisions apply to the distribution of profits between companies that are resident in Romania and in other EU Member States, except for the distribution of liquidation proceeds.

Under the Romanian tax legislation, the application of these provisions is not subject to further "substance" or "business purpose" conditions.

Outbound dividends

No withholding tax applies in Romania if an EU parent company receives dividends from a Romanian subsidiary, provided that the following conditions are met:

- ▶ The parent company holds at least 10% of the shares of the subsidiary (15% up to 31 December 2008).
- ▶ The shares are held for an uninterrupted period of at least two years ending at the dividend payment date.

Even if, at the time of the dividend payment, the two-year holding period has not been satisfied, the withholding tax exemption may apply subsequently, provided that the shares continue to be held so that the two-year holding period is satisfied subsequently. In this case, however, the withholding tax should

be paid initially and, once the two-year holding period is satisfied, a refund may be claimed for the excess withholding tax paid.

A list of categories of companies eligible for the exemption was included in the Romanian legislation.

Inbound dividends

Inbound dividends are considered to be nontaxable income if the following conditions are met:

- ▶ There is a minimum shareholding of 10% (15% up to 31 December 2008).
- ▶ The shareholding is held for an uninterrupted period of at least two years.
- ▶ The Romanian company receiving the dividend income must be a taxpayer for Romanian profits tax, without option or exception.

However, if the two-year holding period is fulfilled after the dividend distribution, the taxpayer may benefit from recomputation of the taxable profits related to the period when the dividend income was initially subject to taxation.

The same rules apply to the Romanian PE of an EU company that receives dividends from subsidiaries from Member States.

A list of categories of companies eligible for the exemption was included in the Romanian legislation.

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Slovak Republic

Is the amended PSD implemented in full?

Yes.

Outbound dividends

According to the Slovak tax law, outbound dividends distributed from profits made after 31 December 2003 are not subject to tax. Dividends from profits accumulated before 31 December 2003 are potentially in infringement of the PSD.

Domestic tax law requires the beneficial owner of the recipient of a dividend to hold at least 25% of the shares of the subsidiary, despite the 10% limit applicable under the PSD with effect from 1 January 2009.

Inbound dividends

According to the Slovak tax law, inbound dividends distributed from profits gained after 31 December 2003 are not subject to tax. Dividends from profits accumulated before 31 December 2003 are potentially in infringement of the PSD.

Domestic tax law requires the beneficial owner of the recipient of a dividend to hold at least 25% of the shares of the subsidiary, despite the 10% limit applicable with effect from 1 January 2009.

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Slovenia

Is the amended PSD implemented in full?

Yes.

Outbound dividends

In line with the PSD, Slovenia's national legislation stipulates the following conditions for claiming the withholding tax exemption under the PSD:

- ▶ With effect from 1 January 2009, the minimum participation requirement is set at 10%. Until 31 December 2008, the threshold was 15%.
- ▶ The holding period for the shares must be at least 24 months. Nevertheless, a company can make use of the benefits of the PSD if it provides a bank guarantee to the tax authority for the potential amount of withholding tax payable if the beneficial treatment were not claimed.
- ▶ The recipient must have one of the legal forms prescribed by the PSD, it must be tax resident in an EU Member State and it must be subject to one of the taxes prescribed in the PSD.

To apply the PSD benefits, taxpayers must also meet certain procedural requirements. A taxpayer must submit documentation to the tax authority with evidence that it satisfies the PSD conditions (detailed above) within 15 days after distributing the dividend.

A withholding tax refund is possible if a taxpayer has paid dividend withholding tax to the tax authority and the 24-month participation requirement is satisfied subsequently.

It should be noted that the Slovenian tax authority denies refund claims in situations where withholding tax was paid even though the conditions to claim the exemption were met at the time of the profit distribution.

The law explicitly disallows the application of PSD benefits to "hidden profit distributions" – a type of deemed dividend. "Hidden profit distributions" are defined as amounts that are not at arm's length that are distributed to a shareholder who owns at least 25% of the taxpayer.

Inbound dividends

Inbound dividends are tax-exempt unless they are received from a resident of a "blacklisted" country (under Slovenian law). No EU countries are on the Slovenian blacklist.

On the other hand, taxpayers must decrease deductible expenditure by an amount equal to 5% of their exempt dividends.

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Spain

Is the amended PSD implemented in full?

Yes. The PSD was implemented in Spain³⁴ with retroactive effect from 1 January 2005.³⁵

Outbound dividends

The PSD, as implemented by the Spanish Nonresidents Tax Law, provides a withholding tax exemption for dividends distributed by Spanish subsidiaries to EU resident parent companies, provided that the following conditions are met:

- ▶ Both the parent and the subsidiary must be subject to and not exempt from corporate income tax in their countries of residence.
- ▶ Both the parent and the subsidiary must have one of the legal forms listed in the Annex to the PSD.
- ▶ The distribution of profits must not be a consequence of the liquidation of the subsidiary.
- ▶ The EU parent company must own at least 10% of the share capital of the Spanish subsidiary. (Under the *Denkavit*³⁶ and *Amurta*³⁷ cases, the exemption for withholding tax could apply in certain cases with a 5% ownership in the Spanish company.)
- ▶ The holding must have been kept for at least one year on the day of the dividend payment.

If the dividend distribution takes place before the year is complete, the dividend is subject to Spanish withholding tax, but the tax is reimbursed once the year is completed (payment and refund system).

In addition, the Spanish tax law³⁸ contains a specific anti-abuse provision. The exemption from dividend withholding tax does not apply if the majority of voting rights of the EU parent company is directly or indirectly held by individuals or legal persons that are not resident in an EU Member State.

However, the Spanish law establishes several “safe harbor” rules. Under these rules, even if the majority of the voting rights of the parent is held by non-EU residents, the dividends may still enjoy the benefits provided by the PSD in any of the following cases:

- ▶ The parent company is engaged in a business activity directly related to that carried on by the subsidiary.
- ▶ The business purpose of the EU parent company is the management and supervision of the subsidiary through the appropriate organization of human and material resources.
- ▶ The parent entity provides evidence that it has been set up with a sound business purpose and not to benefit unduly from the dividend withholding tax exemption given by the PSD.

Inbound dividends

The Corporate Income Tax (CIT) law provides for a participation exemption regime for qualifying dividends and gains received by Spanish resident entities from certain foreign shareholdings. The following conditions must be met to benefit from this regime (several tax rulings have interpreted some of these requirements in a flexible way):

- ▶ A 5% direct and/or indirect participation of the Spanish entity must be held in each and every tier of the company structure for a minimum one-year holding period.
- ▶ The “subject to tax” test means that subsidiaries of the Spanish entity must be subject to a tax that is identical or analogous to the Spanish CIT and must not reside in a tax haven jurisdiction as defined by Spanish tax law.³⁹ This requirement is considered to be met if the subsidiary is a tax resident of a country with which Spain has signed a Double Taxation Agreement.
- ▶ The “business activity” test requires that at least 85% of the foreign subsidiary’s gross revenues must derive from “active” business activities conducted outside Spain.⁴⁰ In the case of a subholding entity, the income obtained from the shareholdings (i.e., capital gains and dividends) is considered to derive from “business activities” if the dividends and capital

³⁴ Law 22/2005.

³⁵ Amending article 14.1. h) Royal Decree 5/2004, the Nonresidents Income Tax Law (NRITL).

³⁶ See footnote 4.

³⁷ Case 379/05 *Amurta*, 8 November 2007

³⁸ Article 14.1 (h) NRITL.

³⁹ The “blacklist” of tax havens for Spanish tax purposes is contained in Royal Decree 1080/1991.

⁴⁰ For these purposes, “active” business income is deemed to derive from “nonpassive” activities. “Passive” income is defined in the Spanish CFC legislation. Broadly, it includes (but is not limited to) income from real estate, holdings and capital gains and income from financial services.

gains are sourced from a lower-tier subsidiary that, in turn, meets the requirements of the Spanish participation exemption regime (i.e., a subholding entity is deemed to comply with this test provided the lower-tier subsidiary carries on a business activity).

In addition, Spain has also set a tax credit system for foreign dividends, which allows taxpayers to also obtain credit for the underlying tax paid by the subsidiary.

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Sweden

Is the amended PSD implemented in full?

Sweden has implemented the PSD.

Outbound dividends

No dividend withholding tax is levied on dividends paid by a Swedish company to a foreign shareholder that fulfills the conditions in Article 2 PSD if the holding is at least 10% of the share capital.

Thus, the Swedish domestic regulations may be considered to be consistent with the PSD.

Swedish tax law is actually more generous than the PSD since dividends paid to a foreign company that is equivalent to a Swedish company are exempt from withholding tax if the shares are held for "business purposes." A foreign company is always considered to be equivalent to a Swedish company if the company is resident and liable to income tax in a country with which Sweden has entered into a Double Taxation Agreement, providing taxation is not limited to certain income and the company is covered by the provisions of the Double Taxation Agreement.

Inbound dividends

A dividend received from a foreign subsidiary is not subject to tax, as long as the shares held are considered to be a "business related holding."

The holding is considered to be "business related" if it is not held as a current asset and it consists of shares in an unlisted company or if the holding represents at least 10% of the voting rights in a listed company. Shares in a listed company must have been held for more than one year at the time of the distribution of the dividend, otherwise no exemption is granted.

Shares held in a company resident in an EU Member State are always considered to be held for "business purposes" (even if they are held as current assets) if the company holding the shares holds 10% or more of the share capital.

However, in order to be considered as a "business-related holding," the foreign subsidiary must also be equivalent to a Swedish company. This criterion is potentially inconsistent with the PSD. In practice, it might not be a major issue, however, since a foreign corporation is always considered to be equivalent to a Swedish company if the corporation is resident and liable to income tax in a country with which Sweden has entered into a Double Taxation Agreement, providing taxation is not limited to certain income and the entity is covered by the provisions of the Double Taxation Agreement. However, in certain situations this condition could be regarded as a restriction that is not allowed under the PSD.

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United Kingdom

Is the amended PSD implemented in full?

The UK domestic law was considered compliant with the PSD at the time the PSD was adopted.

Outbound dividends

Generally, no tax is withheld on dividends distributed from the UK to parent companies in other countries.

Inbound dividends

Under draft UK tax law that is expected to come into effect on 1 July 2009, dividend income received by a UK company from either UK or non-UK sources is exempt from corporation tax if one of a number of qualifying conditions is met.

The exemption applies to 100% of the dividend income, the law does not contain a "minimum shareholding" test or a "period of ownership" test, and it does not contain a requirement that considers the activities of the payer or how the payer is taxed. However, the payer must not be entitled to a deduction for the dividend paid and it must be of an "income" rather than "capital" nature. In broad terms, the qualifying conditions are as follows:

- ▶ The UK company holds less than 10% of the payer's share capital.
 - ▶ The dividend is derived from a transaction that is not undertaken to reduce UK tax.
 - ▶ The dividend is in respect of shares accounted for as liabilities (e.g., preference shares).
- It will be necessary for taxpayers to undertake some due diligence to ensure that one of the qualifying conditions will apply.
- ▶ The UK company "controls" the payer.
 - ▶ The UK company holds "nonredeemable ordinary shares" in the payer.

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