REGIONAL DEVELOPMENTS

European Tax Law*

I. Austria

The Austrian Ministry of Finance recently released a draft bill that would amend the affiliation privilege provided for under Austrian tax law. Austria has become of great interest as a holding company jurisdiction, both for Eastern Europe and elsewhere, due to the extension of the affiliation privilege as of January 1,1989, to foreign holdings if an Austrian company owns at least 25 percent of the share capital. The draft bill will amend these rules, however, to require that the foreign company must be directly or indirectly subjected to foreign income tax comparable with the Austrian tax rules.[1]

Official commentaries to the bill state that at least a 10 percent foreign tax rate must be levied in order to meet this comparability test. It is not yet clear, however, whether all countries with tax rates in excess of 10 percent will automatically qualify.[2] Nor is it clear whether the tax rate must be an effective one or a statutory minimum. Nonetheless, if an Austrian company plans to hold shares in a Soviet or East European joint venture that negotiates favorable local tax relief, close attention should be paid to any changes in Austrian tax law in order to ensure that one does not get "whipsawed" by what would effectively become a form of "sop-up" tax in Austria.

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1. Kuiper, *What's Going On in Austria: Intercorporate Dividends*, 29 EUR. TAX'N 368 (Nov. 1989). In addition, the foreign company could not, itself, place more than 25 percent of its assets in securities or debt instruments. I Taxation of Companies in Europe (IBFD) at Austria-i (Special Sheet Supp. No. 89, Feb. 1990).

2. *Id.* at 369.

II. Finland

The recent tax reforms in Finland have promulgated a full imputation corporate tax system pursuant to the Act on Imputation Tax Credits, which took effect in 1990.[3] The system is basically akin to that of the United Kingdom's Advance Corporation Tax regime.[4] As of 1990, the corporate tax rate increased from 40 percent to 42 percent. Thus, a Finnish shareholder will receive an imputation credit equal to 42/58ths of any dividend received from a domestic Finnish company.[5]

Finland has also enacted a compensatory tax, similar to the French "*precompte*," in order to ensure that any company which distributes dividends pays a tax equal to at least two-thirds of the dividend (i.e., one-third of the total, gross distributable amount). The difficulty that foreign groups having Finnish operations will encounter is that the imputation tax credit will not extend to foreign shareholders of Finnish companies unless such treatment is accorded by double taxation treaties. Even if, or when, the imputation credit is not accorded, the compensatory tax may still be due. Hence, Finland will no longer be a useful jurisdiction for the routing of dividends (which, albeit little known, it has been to date) until and unless they are routed to a country with which Finland has a treaty affording a refund of imputation tax credits.

The Finnish Act on Imputation Tax Credits authorizes the Finnish Government to accord the credit to foreign shareholders based on reciprocity. It is expected that treaties of the United Kingdom and France will be among the first to be renegotiated so as to allow for some inputation tax credit refunds.[6] To the extent that this is eventually accomplished, Finland may remain an interesting jurisdiction through which to route dividends to those countries, especially since the Finnish municipal tax rate has also recently been reduced. Thus, as long as the imputation tax credit and the compensatory tax can be offset and refunded, Finland could prove useful for international tax planning purposes.

III. France

Few things are as revealing of the state of the French body politic as the annual Finance Law. France's Socialist Government submitted the 1990 version to the Parliament on September 8, 1989, and this version represented an interesting mixture of "realpolitik," plain old politics, and social engineering. This legislation was passed as Law No. 89-935 on December 29, 1989.[7]

3. *See* 23 Tax News Serv. (IBFD) 233 (Sept. 20, 1989).
4. *Compare* Gammie, *Stapled Stock—A UK Perspective,* 11 INTERTAX 484, 485-86 (1989).
5. *See generally* Viherkentta, *Finland's New Imputation System Has International Aspects,* 1 TAX NOTES INT'L 349, 350 (Oct. 1989).
6. *Id.* at 351.
7. 24 Tax News Serv. (IBFD) 25 (Jan. 24, 1990).

With the advent of 1993, France must move certain of its tax rates closer to those of its European competitors.[8] The basic corporate income tax rate will be reduced to 37 percent, but a 42 percent rate will continue to be applied if profits are distributed as dividends or otherwise.[9] The consolidation rules will be changed to facilitate intragroup reorganizations.[10] A number of taxes on financial products—including insurance contracts,[11] bonds, and other investment instruments—will be reduced to avoid a flight of French capital abroad once the Common Market in financial services comes into effect. Finally, purchasers of luxury goods, ranging from pearls to videocassette recorders, will benefit from a reduction in the top Value-Added Tax rate to 25 percent.[12]

While these taxes are to be reduced, public spending is not. Alternative revenue sources have therefore been sought. The tax rate on long-term corporate capital gains will be increased from 15 to 19 percent.[13] Other corporate taxes, such as the minimum annual tax and a tax on company cars, will be increased as well. In addition, the profits earned on employee stock options will generally be taxed as capital gains or, for a portion of the profits from particularly favorable plans, as ordinary income.[14]

The social engineering element may be found in the increase in the wealth tax. The well-to-do will also lose certain tax deductions, such as the limited deductions previously available for interest on home mortgages.[15] On the other hand, tax credits or favorable depreciation treatment will be accorded to companies with expenses that the Government wishes to favor, such as expenditures for research and development and antipollution equipment.

IV. Federal Republic of Germany

The United States and West Germany announced the long-awaited signing of a new income tax treaty and protocol to replace the convention that was in effect between the two countries since 1954. The proposed treaty and its accompanying protocol (initialled in January 1989 and signed on August 29, 1989[16]) are now before the United States Senate and the West German Bundestag for ratification. Assuming that instruments of ratification are exchanged by the Contracting States in due course, the proposed treaty takes effect generally on January 1,

8. Regarding this state of intra-EC competitiveness, see Goldsworth, *European Economic Community: The EEC, State Aids, Tax Incentives, and Harmonization*, 1 TAX NOTES INT'L 467 (Nov. 1989).

9. *See generally* 23 Tax News Serv. (IBFD) 244 (Oct. 4, 1989).

10. 24 Tax News Serv. (IBFD) 25 (Jan. 24, 1990).

11. *Id.*

12. *See* 23 Tax News Serv. (IBFD) 233 (Sept. 20, 1989).

13. 24 Tax News Serv. (IBFD) 25 (Jan. 24, 1990).

14. *Id.*

15. *Id.*

16. *See* 1 TAX NOTES INT'L 276 (Sept. 1989); 23 Tax News Serv. (IBFD) 234 (Sept. 20, 1989).

1990, although various ancillary effective dates are provided for in specific instances.

Under the proposed treaty, interest and royalties arising in one country and paid to a resident of the other State would continue to be exempt from withholding taxes at the source. Although portfolio dividends (i.e., those not paid to a corporate parent) would generally remain subject to the current 15 percent withholding tax, the effective rate of West German withholding on such dividends would fall to 10 percent for dividends paid or credited after 1989. The rate of withholding tax on dividends paid by a subsidiary to its corporate parent would fall bilaterally to 10 percent for dividends paid or credited in 1990 or 1991, and to 5 percent for dividends paid or credited in 1992 or thereafter.[17]

The proposed treaty contains a number of other provisions, representing major changes from the existing convention. These changes include a provision that would permit the imposition of a 5 percent branch profits tax beginning in 1991. The proposed treaty also contains anti-"treaty shopping" rules and an unprecedented provision concerning the *mandatory* resolution of tax disputes via arbitration.[18]

V. The Netherlands

A. New Restrictions Imposed on Certificates of Dutch Residence for Dual-Resident Companies

In June 1989, the State Secretary of Finance of The Netherlands ruled that certificates of residence (required in order to obtain benefits under certain tax treaties to which The Netherlands is a party) will no longer be issued to companies incorporated in The Netherlands but having their place of effective management in the United Kingdom.[19] Under article 4(1) and (3) of the Dutch-U.K. Income Tax Treaty of November 7, 1980, such dual-resident companies are treated as U.K. residents. The result is that The Netherlands is not accorded jurisdiction thereunder to tax the worldwide income of such companies. Because of the limited exposure to Dutch taxation enjoyed by these dual-resident companies, the State Secretary of Finance believes that it is not appropriate to issue certificates of Dutch residence to them for tax treaty purposes.

Several major European operations of U.S. multinationals have been structured as Dutch-U.K. dual-resident companies to take advantage of both countries' tax treaty networks. The new position of the Dutch authorities may therefore force such enterprises to re-think their existing overseas structures.

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17. *See* Jacobs, *The Effects of Business Taxation on Shareholder Financing of Corporations—An Analysis of Taxation Concepts in France, Germany and the United States,* 11 INTERTAX 464, 470 n.25 (1989).

18. A full English translation was published as an insert to 29 EUR. TAX'N (Oct. 1989).

19. *See generally* Betten, *Netherlands: Denial of Certificate of Residence to Dual Resident Company,* 29 EUR. TAX'N 371 (Nov. 1989).