



# PRACTICAL EUROPEAN TAX STRATEGIES

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## Articles

### Planning Perspective

#### **EU--New EU Financial Transaction Tax: Why It Seems Set to Impact Financial Institutions Worldwide, and Why Legal Challenges are Likely**

*By Dan Neidle, Chris Bates and Habib Motani (Clifford Chance)* ..... p. 2

### **Belgium--Shifting Gears Towards Transfer Pricing Audits**

*By Isabel Verlinden, Xavier Van Vlem, Patrick Boone and Bram Markey (PricewaterhouseCoopers LLP)* ..... p. 7

### **Finland--Dividend Tax is in Breach of the Free Movement of Capital**

*By Janne Juusela and Einari Karhu (Attorneys at Law Borenius Ltd.)* ..... p. 8

### **Italy--Italian Financial Transaction Tax Goes into Effect in March**

*By Vania Petrella and Gianluca Russo (Cleary Gottlieb Steen & Hamilton LLP)* ..... p. 8

### **Russia--Russia Signs Tax Treaties with Argentina and Latvia**

*By Natalia Nalyutina (Ernst & Young)* ..... p. 10

### **Spain-U.S.--New Protocol to U.S.-Spain Treaty Signals Possible Changes in U.S. Policy on Limitation on Benefits**

*By Bernard Moens, Ronald Bordeaux, Oren Penn, Steve Nauheim, Alexandra Helou, Eileen Scott, Susan Conklin and Lauren Janosy (PricewaterhouseCoopers LLP)* ..... p. 3

### **UK--Tax Law Changes May Affect Fund Industry**

*By Jennifer C. Wheeler and Laurier W. Beaupre (Proskauer Rose LLP)* ..... p. 13

## IN THIS ISSUE

### **Preparing for the EU's Financial Transaction Tax**

The FTT, to be implemented by 11 EU member countries, will affect some companies in London, the U.S. and Asia, and the tax rates could, for practical purposes, exceed the promised 0.1 percent. While the details of some aspects are subject to modification, many of the broad provisions are known, and analyzed. Page 2

### **U.S. Tax Treaty with Spain: A Sign of Things to Come**

Changes to the limitation of benefits provisions impose more restrictions on companies trying to qualify for treaty eligibility. The new protocol between the U.S. and Spain reflects a fundamental shift in U.S. tax treaty policy, and is likely to be repeated in other U.S. tax agreements. Page 3

### **Belgium Beefs Up Transfer Pricing Audits**

The Belgian tax administration has added significant resources to its transfer pricing auditing efforts. Many companies have recently received questionnaires which is the first step in the audit process. Page 7

### **Italy to Roll Out its own Financial Transaction Tax in March**

The Italian FTT will target trades on over-the-counter and public exchanges, at rates of 0.22 and 0.12, respectively. High-frequency trades will be subject to a lower rate. Page 8

**Advisory Board page 6**

## **Finnish Dividend Tax is in Breach of the Free Movement of Capital**

By Janne Juusela and Einari Karhu (Attorneys at Law Borenium Ltd.)

In a case concerning Finnish taxation of dividends paid to foreign pension funds (*Commission v Finland*, C-342/10), the Court of Justice of the European Union has held that Finland breached free movement of capital by introducing and maintaining in force a scheme under which dividends paid to foreign pension funds are taxed in a discriminatory manner in comparison with Finnish pension funds.

According to Finnish tax legislation, dividends received by a domestic pension fund are, in principle, taxed at an effective rate of 19.5 percent. Dividends received by a non-resident pension fund are subject to a rate of tax of at least 15 percent in accordance with the double taxation conventions or a rate of tax of 19.5 percent in accordance with national tax legislation.

However, Finnish pension funds are, in effect, authorized to deduct the amounts reserved in order to meet their obligations as regards pensions, which, in fact, gives rise to a tax exemption for those dividends. Foreign pension funds are taxed without the possibility of their being granted the right to deduct tax from the amounts in reserve before

taxing the Finnish-source dividend in Finland.

The Commission had taken the view that the Finnish tax scheme was discriminatory as regards the dividends paid to non-resident pension funds. The Court of Justice agreed and it did not accept justifications based on the principle of territoriality or cohesion. Furthermore, the Court of Justice found that the double tax conventions concluded by Finland did not offset the unfavorable treatment of foreign pension funds.

Consistent with the recent *Santander* case (Joined Cases C-338/11 to C-347/11), the Court of Justice is continuing to build coherent case law in regard to Member States' discriminatory tax legislation. In accordance with the objectives of the European Union, the Member States' attempts to justify their discriminatory tax legislation by an overriding reason of public interest are being interpreted restrictively.

As a result of judgment C-342/10, foreign pension funds might be entitled to reclaim the withholding taxes levied by the Finnish tax authority. □

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Janne Juusela (Janne.Juusela@borenium.com) is a Partner, and Einari Karhu (Einari.Karhu@borenium.com) is a Senior Associate, with Attorneys at Law Borenium Ltd. in Helsinki. Mr. Juusela's practice is concentrated in corporate and cross-border taxation, and mergers and acquisitions. He is head of Attorneys at Law Borenium's Tax Group. Mr. Karhu's practice is focused on domestic and international tax matters in corporate and personal income taxation. Prior to joining Attorneys at Law Borenium in 2008, he worked as a Senior Officer at the Tax Department of the Ministry of Finance.

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## **ITALY**

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### **Italian Financial Transaction Tax Goes into Effect in March**

By Vania Petrella and Gianluca Russo (Cleary Gottlieb Steen & Hamilton LLP)

On December 21, 2012, the Italian Parliament approved the budget law for 2013 (Budget Law) contemplating, among other things, the introduction of a new tax applicable to certain financial transactions (Financial Transaction Tax—FTT).

While the Budget Law includes an articulate regime of the FTT, some of its features will be established with a Ministerial Decree to be issued by the Ministry of Economy and Finance (Ministerial Decree) within 30 days from the entry in force

of the Budget Law (which is subject to its publication in the Official Gazette, expected to occur soon).

#### **Which Transactions Will Be Subject to the FTT?**

The FTT will apply to transactions involving shares, equity-like financial instruments and derivatives, as well as to high-frequency trades, as follows:

*(Financial Transaction Tax, continued on page 9)*

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Vania Petrella (vpetrella@cgsh.com) is a Partner, and Gianluca Russo (grusso@cgsh.com) is an Associate, with Cleary Gottlieb Steen & Hamilton LLP, resident in the Rome office. Ms. Petrella's practice is focused on Italian and international tax issues related to capital markets, mergers and acquisitions, financial products, and domestic and cross-border transactions. Mr. Russo's practice is concentrated in Italian and international tax matters, including executive compensation and tax implications of employee incentive plans.

*Financial Transaction Tax (from page 8)*

**1. Shares and Equity-Like Financial Instruments**

- *Which Trades on Which Securities?*

The FTT will apply to all trades entailing the transfer of title of (i) shares or equity-like financial instruments issued by companies resident in Italy, and (ii) securities representing the shares and financial instruments under (i), regardless of the residence of the issuer (such shares, financial instruments and securities, altogether the "Securities"). The FTT will also apply to any transfer of ~~shares~~ resulting from the conversion of convertible bonds.

The rules specifically state that the FTT will apply to any such trades even if executed abroad and if all parties involved are not resident in Italy.

- *Tax Rate and Tax Base*

For 2013 only (on the specific date of effectiveness in 2013, see "Effective Date" below), the FTT will apply at a 0.22 percent rate for over-the-counter (OTC) transactions, reduced to 0.12 percent for trades

**The FTT will apply at a 0.02 percent rate on any portion of the orders that are modified or cancelled on a daily basis.**

executed on a regulated market or multilateral trading facility in an EU Member State, or a State that is a member of the European Economic Area (namely, Iceland, Liechtenstein and Norway), included in the list of States and territories allowing an adequate exchange of information with the Italian tax authorities (Regulated Market).

As of 2014, such rates will be reduced to 0.2 percent and 0.1 percent, respectively.

For these types of transactions, the FTT will be levied on a base equal to (i) the value resulting from the net balance of daily trades on the same Security, or (ii) the consideration paid for each trade.

**2. Derivatives**

- *Types of Derivatives*

The FTT will apply to derivatives, such as swaps, futures, options, cash notional forward agreements and credit default swaps, having as a main underlying, or the value of which is mainly linked to, a Security (including warrants, covered warrants and certificates), regardless of whether the derivatives are physically or cash-settled (Derivatives).

As is the case with the Securities, the FTT will apply to any Derivatives even if executed abroad or if all parties involved are not resident in Italy.

- *At Which Tax Rate and on Which Tax Base?*

The FTT on OTC Derivatives will apply at fixed rates,

which vary depending on the type of Derivative concluded and its notional value, up to €200 for transactions exceeding €1 million. The FTT due on Derivatives executed on Regulated Markets will be equal to 20 percent of the ordinary fixed rate and its base may be set with reference to standard agreements, to be indicated in the Ministerial Decree.

Physically-settled Derivatives will be subject to the FTT at the rates indicated under "Shares and Equity-Like Financial Instruments," above, upon the transfer of the underlying Securities occurring. Conceivably, as the technical explanations seem to maintain, the FTT paid upon execution of the Derivative will be deducted from the FTT due upon physical settlement.

**3. High-Frequency Trades**

- *Which Trades?*

The FTT will also apply to high-frequency trading occurring on the Italian financial markets and relating to Securities and Derivatives, as generated by a computer algorithm that automatically determines the decisions related to the relevant orders or metrics, their amendment or cancellation (High-Frequency Trading), in a time frame shorter than the one to be set by the Ministerial Decree, which, in any event, cannot be more than half a second.

- *Tax Rate*

The FTT will apply at a 0.02 percent rate on any portion of the orders that are modified or cancelled on a daily basis, as determined by the Ministerial Decree, which, in any event, shall not be less than 60 percent of the orders inserted.

**Liability for the Financial Transaction Tax**

The FTT cost on Securities will be borne by the purchaser, while the FTT on Derivatives will be borne by both parties of the relevant transactions. The FTT on High-Frequency Trading will be borne by the person on whose behalf the relevant orders are executed.

The FTT will be due by the financial intermediary intervening in the trading activities, namely, the intermediary that receives an order from a client, including non-resident financial intermediaries (enabled to appoint a fiscal representative). Financial intermediaries will be entitled to defer the execution of the trades until their clients provide the funds necessary to pay the FTT. In all other cases, FTT is paid directly by the relevant parties.

**Exemptions**

The FTT will not apply to:

- transactions involving the European Union, the European Central Bank, central banks of EU Member States as well as other central banks and authorities managing official State reserves, and other international organizations established pursuant to international agreements executed by Italy;

*(Financial Transaction Tax, continued on page 10)*

**Financial Transaction Tax (from page 9)**

- market making activities (as defined under Article 2(1)(k) of the EU Regulation No. 236/2012 of March 14, 2012);
- those entities acting on behalf of the issuer to support the liquidity of its shares, in accordance with EU Directive 2003/6/CE of the European Parliament and Council, and of Directive 2004/72/CE of the European Commission;
- Italian pension funds;
- transactions among certain related parties, or in connection with reorganization operations meeting the requirements to be determined with the Ministerial Decree;
- trades in ethical finance products and services as defined pursuant to applicable regulatory rules;
- the following trades relating to Securities:
  - trades of shares that are (i) negotiated on Regulated Markets, and (ii) issued by companies the average market capitalization of which in the month of November of the year preceding the year of the relevant trade was lower than €500 million;

- transfers by reason of death or gift;
- the issuance or cancellation of shares and equity-like financial instruments;
- securities financing transactions, including stock lending or stock borrowing or the lending or borrowing of other financial instruments, a repurchase or reverse repurchase transaction, or a buy-sell back or sell-buy back transaction; and
- the conversion of securities resulting in the issuance of new shares.

**Effective Date**

The FTT will apply to transactions executed (i) as of March 1, 2013, for trades on Securities and High-Frequency Trading on Securities, and (ii) as of July 1, 2013, for Derivatives and High-Frequency Trading on Derivatives.

The rules contemplate a grace period for the payment of FTT due on trades that will be finalized within three months from the publication of the Ministerial Decree; the tax will become payable after six and a half months from such publication.

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**RUSSIA**

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**Russia Signs Tax Treaties with Argentina and Latvia**

By Natalia Nalyutina (Ernst & Young)

Russia has recently ratified new treaties on the avoidance of double taxation with respect to taxes on income and capital with Argentina<sup>1</sup> and Latvia.<sup>2</sup>

The Treaties will come into force on January 1 after the completion of all necessary internal procedures by both contracting states. It is likely that they will be effective from January 1, 2013.

In essence both Treaties follow the principles of the OECD model convention with some variations, including but not limited to the determination of whether a person is a “resident of a Contracting State.” According to the Russia-Argentina treaty, if a person is resident in both Contracting States under the general provisions then its status shall be determined as resident in the State of which he or she is a national. If an individual is a national of neither State, and in all other cases, the competent authorities of the Contracting States are to endeavor to settle the question and determine the mode of application of the Convention to such a person by mutual agreement. Under the Russia-Latvia treaty, it is always the Contracting States’ competent authorities’ duty to determine status of persons resident

in both Contracting States under the general provisions, otherwise treaty benefits cannot be applied.

Under the Russia-Argentina treaty the withholding tax rate on dividends is 10 percent if the recipient is the beneficial owner of at least 25 percent of the capital of the company paying the dividends, and 15 percent in all other cases. The tax rates for interest payments and royalties applicable at source are both capped at 15 percent.

Similarly, under the Russia-Latvia treaty, the tax rate on dividends is 5 percent if the recipient is the beneficial owner of at least a 25 percent interest and the value of its investment in the equity capital of the company paying the dividends is \$75,000 (US) or more. The rate is 10 percent in all other cases. The tax rate for interest is 5 percent regarding loans between financial institutions, and 10 percent for all other cases. The maximum tax rate applicable at source to royalties under the treaty is 5 percent.

Finally, the State Duma is considering a draft law on amendments to the Russia-Luxembourg Double Tax Treaty. The law will decrease the minimum rate of tax on dividends at source from 10 percent to 5 percent and introduce a new article on the exchange of information.<sup>3</sup>

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Natalia Nalyutina (Natalia.Nalyutina@ru.ey.com) is a Senior, Business Tax Advisory, with the Moscow office of Ernst & Young.

<sup>1</sup>Federal law No. 155-FZ of October 2, 2012.

<sup>2</sup>Federal law No. 156-FZ of October 2, 2012.

<sup>3</sup>Draft law No. 143267-6. □