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Supreme Administrative Court rules on EC-Compatibility of the international participation exemption regime

Under the Austrian participation exemption regime, dividends received by a company resident in Austria from a domestic company are in any event tax exempt, while, in contrast, dividends from a foreign company are only exempt if a minimum holding requirement (now at least 10 per cent) and a holding period (now a continuous period of at least one year) are fulfilled; this latter regime is Austria's implementation of Article 4 of the Parent-Subsidiary Directive. It has long been questioned in legal writing whether such differentiation between domestic and cross-border situations constitutes a prohibited restriction of the free movement of capital.[1] In its judgment of 13 January 2005, the Tax Senate (UFS) of *Linz*[2] endorsed this position and held that the differentiations amounts to a prohibited discrimination and that taxpayers, whose holdings do not fulfill the minimum requirements, are nevertheless entitled to an analogous application of the exemption available in domestic situations.[3] The tax administration has appealed the Tax Senate's judgment and on 17 April 2008[4] the Austrian Supreme Administrative Court (*VwGH*) has rendered its final decision without referring the case to the ECJ.

As expected, the Supreme Administrative Court agreed with the Tax Senate that the Austrian differentiation infringes on the freedom of capital movement and can neither be justified by the coherence of the tax system nor by the fact that the discriminatory regime is an implementation of the Parent-Subsidiary-Directive. The Administrative Court, however, held that primary EC law only supersedes domestic law and that it is for the domestic court to determine the legal ramifications of such 'suppression' in a way that fits the policy decisions of the domestic legislator best. In doing so, the Administrative Court focused the minority shareholding in the case at hand and found that, in the light of the ECJ's decision in *FII Group Litigation*,[5] the EC incompatibility of Austria's regime can be cured by granting an (indirect) foreign tax credit instead of an exemption. Any remaining disadvantage would then be based on mere disparities, such as different tax rates or bases in the different Member States.

The Austrian Federal Ministry of Finance has already issued an information implementing this judgment[6] and now allows for a credit for foreign corporate tax for all inter-company dividends from the EU Member States and Norway[7] that do not fulfill the criteria for exemption. The case is now again pending before the Tax Senate, which will also have to rule on the third-country aspects under Article 56 of the EC Treaty. In this respect the Administrative Court has already given some hints: first, the freedom of capital movement and hence protection in a third-country setting will not apply if the shareholding is in fact a holding that is protected by the freedom of establishment.[8] Secondly, even if the freedom of

1 See, for example, Georg Kofler and Michael Tumpel, 'Double Taxation Conventions and European Directives in the Direct Tax Area', in Michael Lang, Josef Schuch and Claus Staringer (eds), *Tax Treaty Law and EC Law* (Linde, Vienna, 2007) pp. 191, 200 *et seq.* with further references.

2 *UFS Linz*, 13 January 2005, RV/0279-L/04, available at https://findok.bmf.gv.at.

3 For a discussion of this decision see Georg Kofler and Gerald Toifl, 'Austria's Differential Treatment of Domestic and Foreign Inter-Company Dividends Infringes the EU's Free Movement of Capital', *European Taxation* 2005, vol. 45, p. 232.

4 *VwGH*, 17 April 2008, 2008/15/0064, available at http://www.ris.bka.gv.at/vwgh.

5 ECJ, 12 December 2006, Case C-446/04, *FII Group Litigation*, [2006] ECR I-11753.

6 This information (BMF-010216/0090-VI/6/2008) was published on 13 June 2008; it is available (in German) at https://findok.bmf.gv.at, and was reprinted in *Finanz Journal* 2008, p. 274, in *Österreichische Steuerzeitung* 2008, p. 270, and in *Steuer- und Wirtschaftskartei* 2008, section 528.

7 Norway is the only EEA country with which Austria has an agreement that includes mutual assistance also concerning the recovery of tax claims.

8 This position seems to have been confirmed by the ECJ's subsequent decision in Case C-284/06, *Burda*, paras 71 *et seq.*; for this discussion see, e.g., Axel Cordewener, Georg Kofler and Clemens Ph. Schindler, 'Free Movement of Capital, Third Country Relationships and National Tax Law: An Emerging Issue before the ECJ', *European Taxation* 2007, vol. 47, pp. 107, 112 *et seq.*

capital movement would apply to a portfolio holding,[9] the Administrative Court pointed at the ECJ's decision in *A*[10] and the increased justification leeway Member States seem to enjoy in third-country situations. Finally, the Administrative Court's holding, read in the light of the ECJ's decision in *FII Group Litigation* and *Columbus Container Services*,[11] implies that Austria's anti-avoidance provision concerning the international participation exemption, which foresees a switch-over from exemption to the indirect credit system if the foreign distributing company derives mainly passive income and is subject to low taxation in its country of residence, is in accordance with EC law.

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[9] Based on the factual circumstances the Administrative Court did not refer to the grandfathering clause of Art. 57 of the EC Treaty that may protect Austria's regime from scrutiny when direct investments in third countries are at issue; for these issues see Georg Kofler and Gerald Toifl, 'Austria's Differential Treatment of Domestic and Foreign Inter-Company Dividends Infringes the EU's Free Movement of Capital', *European Taxation* 2005, vol. 45, pp. 232, 239–241, and most recently UFS Vienna, 14 December 2007, RV/0303-W/03.

[10] ECJ, 18 December 2007, Case C-101/05, *A*, [2007] ECR I-11531.

[11] ECJ, 6 December 2007, Case C-298/05, *Columbus Container Services*, [2007] ECR I-10451.