

the capital of a capital company by the capitalization of profits or of permanent or temporary reserves, transactions which assume that there is a transfer for values leading to an increase in capital contributing to a strengthening of the

economic potential of the company. On the other hand, a Member State is not entitled to charge capital duty solely on the basis of an increase in the nominal capital which does not contribute to such strengthening.

REPORT FOR THE HEARING delivered in Case 36/86 *

I — Facts and procedure

Council Directive 69/335/EEC of 17 July 1969 concerning indirect taxes on the raising of capital was implemented in Denmark by the provisions of Law No 284 of 23 May 1973, as subsequently amended.

Article 4 (2) (a) of the directive provides as follows:

'The following transactions may be subject to capital duty:

- (a) an increase in the capital of a capital company by capitalization of profits or of permanent or temporary reserves'.

Article 4 of Danish Law No 284 (which is intended to correspond to Article 4 of the directive) is drafted as follows:

'Article 4 — Liability to capital duty shall arise in the following circumstances:

...

- 3. Where the share capital of the company liable to duty is increased by capitalization of profits or of permanent or temporary reserves.'

Investeringsforeningen Dansk Sparinvest (hereinafter referred to as 'Dansk Sparinvest') is an investment society formed in 1968. The society is made up of four sections, known as A, B, C and D. Section C was formed in 1975.

Each section is independent and has its own accounts. The sections have a joint management whose supreme body is the general assembly, which annually elects a board.

The board appoints a director responsible for everyday administration. Section C is what is known as an 'accumulating' section,

* Language of the Case: Danish.

which means that it does not pay dividends to the members. The profit on dealings and the dividends which accrue to the society are simply added to its assets. The certificates issued, which are made out in nominal amounts, represent a proportional share in the assets of the society as they stand for the time being.

Capital duty was paid, pursuant to Articles 4 (1) and 6 (1) of Law No 284, in respect of the formation of Section C. Since then new certificates have been issued on payment and on those occasions too capital duty has been paid. The certificates are quoted on the stock exchange. Duty is calculated on the quoted value of the certificates issued as at the date of issue.

In December 1979 the quoted value of Section C's certificates was about 200 and, in order to make the certificates more readily transferable, it was decided on 3 December 1979 to convert the certificates in such a way that for each certificate in existence the certificate holders would receive two new ones each of which had the same nominal value as the one replaced. The total nominal value of the certificates was thereby doubled, but since this was done without a quid pro quo of any kind from the holders of the certificates (and the paid-up capital of that section was not increased), it had the desired effect of causing the quoted value to fall by about one half, or approximately 100.

On account of that transaction the revenue authorities charged, on the basis of Article 4 (3) of Law No 284, capital duty, which Dansk Sparinvest paid on 24 June 1980

subject to the right to request its refund. The duty was calculated after deduction of the duties paid over previous years in connection with issues of certificates.

Taking the view that the conversion of the certificates of Section C did not give rise to any liability to capital tax, Dansk Sparinvest brought an action before the Østre Landsret (Eastern Division of the High Court), which ordered the Ministry of Fiscal Affairs to refund the capital duty which had been paid. This, together with interest, amounted to DKR 1 049 062. The Ministry of Fiscal Affairs appealed against that judgment to the Højesteret (Supreme Court).

On 28 January 1986 the Højesteret decided, pursuant to Article 177 of the EEC Treaty, to suspend the proceedings until the Court of Justice had given a preliminary ruling on the following questions:

- '(1) Are Articles 10 and 11 of the Council Directive of 17 July 1969 concerning indirect taxes on the raising of capital to be understood as meaning that it is not permissible for a Member State to subject capital companies, within the meaning of Article 3 of the directive, to taxes or duties in connection with the transactions mentioned in Articles 10 and 11 other than capital duty and the duties mentioned in Article 12?
- (2) Is Article 4 (2) (a) of the directive to be understood as meaning that an increase in company capital effected by a transfer to it of the values mentioned in that provision is a precondition for the

charging of capital duty within the meaning of the said provision or is a Member State entitled to charge capital duty simply on the basis of an increase in nominal capital?

It appears from the request for a preliminary ruling that the parties agree that the calculation of the capital duty was effected in conformity with Article 5 (3) of the directive.

The request for a preliminary ruling was received at the Court Registry on 11 February 1986.

In accordance with Article 20 of the Protocol on the Statute of the Court of Justice of the EEC, written observations have been submitted by Dansk Sparinvest, the respondent in the main proceedings, represented by Egon Høgh, Advocate; by the Danish Government and by the appellant in the main proceedings, the Danish Ministry of Fiscal Affairs, represented by Laurids Mikaelsen and Elkie Andersen, respectively; by the Government of the Netherlands, represented by E. F. Jacobs, Secretary-General acting for the Minister for Foreign Affairs; and by the Commission of the European Communities, represented by Johannes Føns Buhl, Legal Adviser.

Upon hearing the report of the Judge-Rapporteur and the views of the Advocate General, the Court decided to open the oral procedure without any preparatory inquiry.

II — Written observations submitted to the Court

Dansk Sparinvest, the respondent in the main proceedings, contends that Article 4 (3) of the Danish Law must be interpreted consistently with Article 4 (2) (a) of Directive 69/335/EEC. Consequently, it does not allow capital duty to be imposed in cases not provided for in the directive. In the case in point, the conversion of Section C's certificates cannot, in its view, be equated with an increase within the meaning of the aforementioned Article 4 (2) (a).

It contends that the increase of share capital by way of the issue of bonus shares is a legal transaction of an administrative nature in so far as the shareholders resolve that the share capital will be increased by a specific amount, which is to result, quite specifically, from a transfer from the company's reserves. Such a decision has a series of consequences from the company-law and accounting points of view. Shareholders will have to forego the amount thus converted into share capital in so far as that amount could have been paid out in the form of dividends. Apart from the necessary accounting entries, the company's statutes must be amended and returns must be made to the limited companies registry. It is that change, together with the increase in capital ensuing therefrom, which is subject to capital duty under Article 4 (2) (a) of the directive. That provision is based on a distinction between, on the one hand, the company's share capital and, on the other, its reserves. The event, which, under the directive, triggers the payment of capital duty is the transfer of an amount from a company's reserves to its share capital.

In contrast, the conversion of certificates at issue differs so greatly from an issue of bonus shares by a limited company that Article 4 (2) (a) cannot apply thereto. Section C received no contribution of

capital whatsoever as a result of the conversion. Certificate holders did not forego any rights. In contrast to shareholders in a limited company, certificate holders cannot dispose of the profits of Section C. There was no change either in the value of Section C's assets (own resources) or in its balance sheet. The only change is that the accounts record the fact that there is now a higher amount of certificates in circulation. However, the nominal amount of the certificates does not appear in the balance sheet. The only consequence of the conversion operation was to double the nominal amount of the certificates and decrease by half the price quoted on the stock exchange.

Dansk Sparinvest rejects the argument that the provisions of Article 4 (2) (a) on capital duty are not linked to specific conditions with regard to the accounts but simply to the existence of a nominal increase in the number of certificates. It elected to double the nominal value of the certificates and by that means to reduce the quoted price of the certificates by half in order to attain roughly parity. Had another price been aimed at, the view put forward by the Ministry of Fiscal Affairs would have resulted in the payment of an entirely different amount of capital duty. For example, if a quoted value of 25 had been sought to be attained for the certificates, the capital duty would have amounted to more than DKR 20 million. It is inappropriate that the amount of capital duty levied on such a measure should depend on the aim pursued by that measure, in this case, a change in the quoted value of the certificates for trading reasons.

Dansk Sparinvest contests the view put forward by the Ministry of Fiscal Affairs to the effect that, since Law No 284 on Capital Duty replaced Article 55 of the Law on Stamp Duty, administrative acts entailing

the issue of securities which would have been subject to stamp duty under the repealed Article 55 must be liable to capital duty. In its view, capital duty is not linked to the issue of securities but to contributions or transfers of assets to the capital of the company.

It observes that, in keeping with the purpose of the directive, Articles 10 to 12 provide an exhaustive list of cases in which Member States are authorized to charge capital duty. Article 5 (1) (c) cannot be relied on as authority for charging capital duty solely on the ground of an increase in the nominal amount of the company's capital in the absence of capitalization or a transfer of capital. That provision merely indicates the sums to be taken as the basis for calculating capital duty.

Dansk Sparinvest proposes that the Court should answer the first question and the first limb of the second question in the affirmative and the second limb of the second question in the negative.

The Danish Government and the Ministry of Fiscal Affairs commence by setting out general remarks on company law, the legal nature of the respondent company, the Danish antecedents of capital duty and the judgment of the Østre Landsret. They point out, in particular, that when Directive 69/335/EEC was incorporated into Danish law, stamp duty on the issue of shares and the like was replaced by capital duty.

The Danish Government considers that the first question can be answered in the affirmative. It is clear from the preamble, the wording and the structure of the

directive, that it aims to introduce harmonized rules on the taxation of capital-raising transactions as defined in the directive and that those rules preclude the charging of other taxes. The very wording of Articles 10, 11 and 12 confirm that view especially.

As for the second question, in the view of the Danish Government, the important question is whether in a situation such as the one involved in this case a Member State is entitled to charge capital duty in the case of an increase in capital made on the basis of other components of the corporate assets and hence in the absence of genuine contributions by the members of the company.

It is common ground between the parties that Dansk Sparinvest is a capital company within the meaning of Article 3 (1) (b) of the directive.

Article 4 (2) (a) applies to all types of capital companies whether there are detailed accounting rules for the type of company providing for a special breakdown of various parts of the corporate assets, including permanent and temporary reserves, or whether the permanent and temporary reserves are incorporated in the corporate assets as 'hidden' values.

The test for the application of Article 4 (2) (a) should be whether the capital of the company was increased by capitalization of funds which are part of the assets of the company and represent the profits of the company as distinct from its original capital.

It is for that reason that Article 4 (2) (a) must be understood as meaning that capital duty may be charged where the capital is increased by capitalizing other corporate assets. The words 'profits or permanent or temporary reserves' therefore signify something which is complementary to the actual capital of the company in the sense that together they constitute the total assets of the company.

As a result, Article 4 (2) (a) provides that an increase in the corporate capital without an actual contribution of capital may be subject to capital duty. Consequently, that provision constitutes an exception to the rule laid down in Article 4 (1), which presupposes the contribution of new funds and hence an increase in corporate assets.

As for Dansk Sparinvest's contention that the increase is merely an increase in 'nominal' capital, the Danish Government argues that under Article 5 (1) (c) of the directive the duty charged on an increase in the capital of a company by capitalization is to be charged on the nominal amount of such increase, whether or not there was an increase in the value of the assets of the company.

The capital of a company is not merely a formality either upon the formation of the company or in other circumstances. The amount of the corporate capital is of real importance both in company law and in tax law. In this case, even if the increase in corporate capital was effected in order to reduce the quoted price of the certificates of the investment society, as in the case of any other form of increase in funds it resulted, in a certain way, in an indirect distribution of profits.

The Danish Government proposes that the Court should answer the second question in the following terms:

'Article 4 (2) (a) of Council Directive 69/335/EEC of 17 July 1969 must be interpreted as meaning that a Member State may charge capital duty in the event of an increase in the capital of a capital company as defined in Article 3 of the directive by the capitalization of other elements of the corporate assets, that is to say without the contribution of new funds.'

The Government of the Netherlands contends that in view of the last recital in the preamble to Directive 69/335/EEC the first question must be answered in the affirmative.

As regards the second question, the Government of the Netherlands considers that this case involves the capitalization of profits or of permanent or temporary reserves. Since capital duty has not previously been charged on the capital raised it should be paid now. If such a case were to arise in the Netherlands, capital duty would be charged on the increase in capital.

The Commission states that Directive 69/335/EEC provided for the abolition of stamp duty on securities and for the abolition of all indirect taxes other than capital duty. Since the directive harmonized all factors relevant to the determination of capital duty, the incidence of that duty is the same throughout the Community. As far as Denmark is concerned, the Commission states that the entry into force of Law No 284 on Capital Duty went hand in hand with the repeal of Article 54 of the Law on

Stamp Duty, which related to stamp duty on shares.

The Commission considers that account must be taken of the fact that Directive 69/335/EEC aims to foster the free movement of capital. The directive covers only indirect taxes on the raising of capital and hence has no impact in the field of the taxation of physical persons or corporations. Its provisions completely harmonized all factors relevant to the charging of the duty, that is to say, in particular, the basis of assessment and the conditions of liability for the tax.

Article 12 lists taxes which the Member States may charge notwithstanding Articles 10 and 11. The Commission considers that the authorizations granted by Article 12 to charge certain taxes constitute a restrictive list of the exemptions authorized by the directive with regard to the taxation of operations falling within its scope. That list does not cover a conversion of certificates such as that at issue in this case.

The Commission points out that, when the bill on capital duty was submitted to the Danish Parliament, the Minister for Fiscal Affairs stated that capital duty replaced Article 54 of the former Law on Stamp Duty. However, in the Commission's view, Article 4 (2) (a) of the directive confers the power to charge capital duty only in the event of an increase in the capital of a capital company.

As regards the conditions under which liability for capital duty arises, the Commission considers that the nominal value of the certificates issued by Dansk Sparinvest is to be regarded as the basis for calculating the share of each certificate holder in the assets of the section in question, as appears from Article 19 of the

statutes of the society. That article provides as follows: 'each share shall have a value corresponding to the value of the assets of the section divided by the number of shares in circulation (the calculation shall be carried out separately for each section)'. Consequently, the doubling of the number of certificates does not seem to have constituted an operation corresponding to the capitalization of profits transferred to reserves within the meaning of Article 4 (2) (a) of the directive, since, under Article 15 of the statutes, the net profit of the section concerned had already been incorporated in the section's assets, which determined the value of the certificates.

The Commission contends that, in order to determine whether the conversion of certificates is capable of constituting a transaction involving the capitalization of profits or of permanent or temporary reserves and hence warrants the charging of capital duty, it must not be overlooked that there is an infinite number of legal structures for companies, associations or legal persons which may be assimilated to capital companies under Article 3 (2) of Directive 69/335. It is therefore not possible to provide an automatic, unqualified definition of the concept of 'nominal value' which can be applied in every case. In order to assess the impact of an increase or decrease in 'nominal value' it must be ascertained whether the legal structure of each company, association or legal person, as it is determined by the applicable national legislation and the statutes of the capital company in question, suggests that what is involved is an increase in the capital of a capital company which has been carried out otherwise than by means of an increase in its nominal capital. It is for the national court to determine what kind of company is

involved in the particular case and to decide in which cases there has been an increase in capital through the 'capitalization' of profits or of permanent or temporary reserves. In order to do so, the national court should base itself on the criteria for interpreting Directive 69/335/EEC provided in the relevant judgments of the Court of Justice. The Commission refers in that connection to the judgments of the Court of 27 June 1979 in Case 161/78 *P. Conradsen A/S v Ministeriet for Skatter og Afgifter* [1979] ECR 2221 and of 15 July 1982 in Case 270/81 *Felicitas Rickmers-Linie KG & Co. v Finanzamt für Verkehrsteuern* [1982] ECR 2771. That assessment should also take account of the business of the company.

The Commission proposes that the Court should answer the questions referred by the national court in the following terms:

- '(1) A Member State is not authorized to subject capital companies to taxes other than capital duty in connection with the transactions mentioned in Articles 10 and 11 of Council Directive 69/335/EEC, with the exception of the duties mentioned in Article 12 of that directive.
- (2) It is for the national courts to determine, by examining the statutes of the capital company concerned and its business, whether a mere increase in the nominal capital of that company is capable of justifying the charging of capital duty under Article 4 (2) (a) of Council Directive 69/335/EEC and the case-law of the Court relating to that directive.'

T. F. O'Higgins
Judge-Rapporteur