EU Tax News – May/June 2021

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CJEU Developments

Belgium – CJEU Referral regarding the tax treatment of dividend received deduction carried forward in the case of a tax-neutral merger

In a judgment of 29 April 2021, the Belgian Court of Appeal of Brussels referred a question to the CJEU for a preliminary ruling regarding the tax treatment of dividend received deduction (DRD) carried forward in the case of a tax-neutral merger (*C-295/21*, *Allianz Benelux*).

In this case, two insurance companies had absorbed several companies upon mergers in 1995 and 1999. The absorbed companies had DRD that could be carried forward to subsequent years.

At the time of the events, in the case of a tax-neutral merger, there was no provision in Belgian law governing the transfer to an absorbing company of the DRD carried forward of an absorbed company. However, for carried forward tax losses a specific rule provides that upon a tax-neutral merger, a proportion of the carried forward tax losses of an absorbed company can be transferred to the absorbing company, in particular, in proportion to the share of the net tax assets of the merging companies. Although this "pro rata rule" for tax losses was extended to DRD carried forward at the end of 2017 and was even before that date already applied to DRD carried forward by the Belgian Rulings Office, at the time of the facts of this case such "pro rata rule" did not yet exist for DRD carried forward. Nevertheless, the Belgian tax authorities and the Court of First Instance accepted the carry-over of the DRD carried forward to the absorbing company to the extent of the "pro rata rule" provided for tax losses, while the taxpayer requested the full carry-over of DRD carried forward.

To understand the reasoning of the taxpayer, one should know that the Belgian DRD regime provides that a dividend received is first included in the taxable base of the company, after which 95% (currently 100%) of the dividend can be deducted from this base, but only to the extent that taxable profits remain. Following the CJEU's *Cobelfret* Judgment (*C-138/07*), the Belgian legislation was amended to allow excess DED to be carried forward to future taxable periods. However, the disadvantage of the "inclusion-deduction" method still remains and the current Belgian regime, by not providing for the carry-over of the entire amount of the DRD carried forward to the absorbing company, has the effect that at the time of the merger the dividends concerned are indirectly taxed. In this respect, upon request of the taxpayer, the Belgian Court of Appeal of Brussels asks the CJEU whether, in absence of a specific provision providing for the transfer of the entire amount of the DRD carried forward of the absorbed companies to the absorbing company upon a tax-neutral merger, the above-described rules of the DRD regime are compatible with Article 4(1) of the EU's Parent-Subsidiary Directive and the Third and Sixth Company Law Directives.

This question is relevant for companies with DRD carried forward involved in a tax-free restructuring. The answer of the CJEU could also have an impact on the existing "pro rata rule" that was introduced for DRD carried forward at the end of 2017.

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National Developments

Denmark – Supreme Court rejects Fidelity Funds withholding tax reclaim on Danish sourced dividends

On 24 June 2021, the Danish Supreme Court denied the refund of withholding tax on Danish sourced dividends suffered by non-Danish investment funds. The claimants are investment funds resident in the United Kingdom and Luxembourg and qualify as Undertakings for the Collective Investment of Transferable Securities (UCITS) (hereafter "the Funds" or "the claimants"). The Funds invested in Danish shares and received dividends in the period 2000-2009, which were subject to Danish withholding tax.

The main question in the cases was whether non-resident investment funds could be subject to withholding tax on dividends received from their Danish shares while resident investment funds that have elected for the investment funds with minimum taxation status are tax exempt on Danish sourced dividends.

In a previous instance, the Danish Eastern High Court had referred the question of compatibility of the withholding tax legislation to the CJEU (*Fidelity Funds* (*C-480/16*)).

The CJEU stated in its preliminary ruling in June 2018 that Article 63 TFEU must be interpreted as precluding legislation of an EU Member State, such as that at issue in the main proceedings, under which the dividends distributed by a company resident in that EU Member State to a non-resident UCITS are subject to withholding tax, while dividends distributed to a UCITS resident in that same EU Member State are exempt from such tax, provided that the undertaking makes a minimum distribution to its members, or technically calculates a minimum distribution, and withholds on that actual or notional distribution the tax payable by its members.

Surprisingly, on 2 April 2019, the Danish Eastern High Court ruled against the CJEU ruling and ruled in favour of the Danish government. The claimant appealed the ruling to the Danish Supreme Court.

The Danish Supreme Court outlined in its judgment that there are two conditions that must be met for a foreign UCITS to receive Danish sourced dividends tax-free: (i) that they are domiciled in Denmark, and (ii) that they have elected for the Danish investment funds with minimum taxation status.

The Danish Supreme Court found that the CJEU had ruled that only the Danish domicile criterion is a breach of EU law, whereby a foreign UCITS must continue to have the status of UCITS with minimum taxation in order to be entitled to a refund of the Danish dividend tax. Hence, the Danish Supreme Court rejected the Fidelity Funds withholding tax reclaim based on the fact that none of the claimants had elected for the Danish investment funds with minimum taxation status.

The Danish Supreme Court disregarded the fact that even if the non-resident funds had elected for the Danish investment funds with minimum taxation status, the Funds would not have been able to benefit from the exemption due to the Danish domicile criterion. Moreover, the Danish Supreme Court disregarded the fact that an obligation to calculate a minimum income would probably be an unlawful discrimination of foreign investment funds itself, since it is a technical trade barrier.

The Danish Supreme Court judgment is final and cannot be appealed to a higher Court.

It must therefore be expected that the reclaims in all pending cases before the Danish Tax Agency and National Tax Tribunal will be denied. A decision from the National Tax Tribunal can be brought before the Danish courts, but it is highly unlikely that the Danish courts will refer additional questions to the CJEU which means that the current judgment from the Danish Supreme Court will remain unquestioned.

Accordingly, at this moment there is no basis for filing new claims with the Danish Tax Agency. We note that as of 1 January 2022, the Danish tax legislation has been amended to impose a 15% withholding tax on Danish sourced dividends received by Danish investment funds with minimum taxation status. Consequently, foreign investment funds are no longer subject to discrimination.

The judgment clearly shows that the legal framework where national courts refer questions to the CJEU for preliminary rulings might not always be sufficient remedy to secure fundamental rights under the EU Treaty especially in complex cases like this one. The correct outcome is, among others, highly dependent on all relevant questions being referred to the CJEU by the national courts in the first place.

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Finland – Supreme Administrative Court follows CJEU on the tax treatment of profit distributions by a Luxembourg UCITS SICAV to a Finnish resident individual

The Finnish Supreme Administrative Court (SAC) has followed the CJEU's decision of 29 April 2021, in *E vs. Veronsaajien oikeudenvalvontayksikkö* (*C-480/19*) concerning the tax treatment of profit distributions by a Luxembourg UCITS SICAV to a Finnish resident individual (see for full background: *EUDTG Newsletter Issue 2021 - nr.3*). The SAC stated that the profit distribution by the Luxembourg UCITS SICAV must be regarded as capital income (taxed at 30/34%) instead of earned income (taxed at progressive rates up to approx. 55%) within the meaning of Finnish tax law in the Finnish resident individual's tax assessment.

The SAC considered that, taking into account the applicable Finnish domestic tax rules' objective and purpose, the Luxembourg UCITS SICAV in question and Finnish UCITS investment funds were in an objectively comparable situation, as both funds were exempt from income tax and the funds' profits were taxed only at the level of the underlying investors. Hence, the tax treatment of the distributions received by the Finnish resident individual as earned income was contrary to free movement of capital. As with the CJEU, the SAC found no acceptable overriding reasons in the public interest that could justify restriction on the free movement of capital.

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Germany – Federal Parliament passes ATAD Transposition Act

In late June 2021, the German Federal Parliament passed the so-called ATAD Transposition Act (ATAD-Umsetzungsgesetz) which integrates the two EU ATAD Directives (2016/1164 of 12 July 2016 and 2017/952 of 29 May 2017) into domestic law.

The adoption of the law took place with great delay. Part of it should already have been implemented as early as 31 December 2018. Therefore, the German government is facing an infringement procedure initiated by the European Commission.

The new law entails important changes to the German tax provisions, which are very briefly described below. In particular, they relate to:

Hybrid mismatch arrangements
Where a hybrid mismatch leads to a deduction/non-inclusion or double deduction situation, the new Section 4k of the Income Tax Act is designated to disallow the deduction of expenses for German tax purposes. Other amendments to the law were made to ensure the inclusion of income when the income is not taxed in another country due to a hybrid mismatch, e.g., by denying the application of the participation exemption. The new rules are (retroactively) applicable as of 1 January 2020.

CFC taxation
Some amendments to the German CFC rules favour the taxpayer, others do not. Contrary to the current rules German residents must in the future be related to each other to exercise control over a foreign corporation (i.e., own more than 50% of the shares altogether) for the CFC rules to apply. By contrast, dividends will no longer constitute active income in all cases, under certain conditions, they will be passive and, therefore, subject to CFC taxation. The new rules will apply as of 1 January 2022.

Exit taxation
Adjustments to the existing German exit taxation rules particularly include: (i) a unification of the methods for a deferral of the tax payments, and (ii) the alignment of the rules that result in a step-up of the German tax base in cases where the German taxation right is extended or established for the first time. The entry into force of the adjustments has been regulated for each rule individually and must be checked against the facts of the concrete case.

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Germany – Federal Parliament passes Tax Haven Defence Act

In late June 2021, the German Federal Parliament passed the so-called Tax Haven Defence Act (Steueroasen-Abwehrgesetz). Its purpose is to implement into German law the conclusions of the Council of the EU on Annex I of the EU list of non-cooperative jurisdictions for tax purposes (so-called "blacklist") as well as the measures negotiated and approved by the EU Council and the EU Code of Conduct Group (Business Taxation).

The law provides for the implementation of defence measures in cases where a taxpayer maintains a business relationship or owns a shareholding in respect of certain non-cooperative states.

A state shall be considered non-cooperative if *all* of the following conditions are met:

- The state is listed on the so-called EU "blacklist" which is amended from time to time and published in the Official Journal of the EU;
- The state: (i) does not ensure sufficient transparency in tax matters, (ii) engages in unfair tax competition, or (iii) has not committed itself to implementing the minimum standards of the OECD/G20 BEPS framework against base erosion and profit shifting; and
- The state is named as being non-cooperative in an envisaged legislative decree issued by the German Federal Ministry of Finance with the consent of the German Federal Council.

The Act contains various defence measures, e.g.

- Expenses from business transactions with residents of non-cooperative states shall be not deductible for tax purposes.
- German CFC rules are extended to active income generated by a resident company of a non-cooperative state.
- Notwithstanding Germany's anti-treaty shopping rules, no tax refund or tax exemption of WHT shall be granted if more than 10% of the shares in a foreign company are directly or indirectly held by individuals resident in a non-cooperative state.
- Residents of non-cooperative states shall be subject to German WHT tax of 15.825% in respect of certain income from trade, service, or financing activities.
- The participation exemption is denied to German residents in respect of their dividends and capital gains if the distributing/transferred company is a resident of a non-cooperative state.

The Act also foresees rules as to which of the defence measures applies first (i.e., so that no cumulative application is given). The provisions of the Act shall apply as of 1 January 2022 provided that the non-cooperative State was named on the EU blacklist on 1 January 2021.

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Italy – Supreme Court decision on the acceptability of commercial reasons underlying the grant of an intragroup interest free loan in line with CJEU case-law on freedom of establishment

On 20 May 2021, the Italian Supreme Court issued its decision (n. 13850/2021) in a case concerning the application of Italian transfer pricing rules with respect to the grant of an intragroup interest free loan to a foreign subsidiary. The case originates from a tax assessment of the Italian Tax Authorities which contested – based on the Italian transfer pricing rules - the absence of interest income on a loan granted by an Italian corporate taxpayer in favour of a controlled 'vehicle' entity resident in Hong Kong for the purpose of the indirect acquisition of a majority stake in a target Chinese company.

The Italian company started a litigation against the assessment. The Tax Court of First Instance confirmed the Italian Tax Authorities' assessment. The Tax Court of Appeal, however, upheld the taxpayer position according to which: (i) such financing was made necessary only because of the impossibility for the Italian company to directly acquire stakes in Chinese companies and (ii) the Italian Tax Authorities did not prove the interest of the Hong Kong affiliate to obtain such financing and pay interest on it.

The Italian Tax Authorities appealed to the Italian Supreme Court which annulled the Tax Court of Appeal judgment and requested a re-assessment of the proceeding based on the following principles of law: (i) firstly, the Italian Supreme Court, quoting previous case-law on the matter, affirmed that the Italian Tax Authorities have the burden to prove that the conditions of a specific intra-group transaction go beyond what unrelated companies would have agreed under market conditions in sufficiently comparable transactions; (ii) secondly, the taxpayer shall be allowed to provide contrary evidence that the conditions applied are arm's length or, alternatively, – in line with the principle outlined by the CJEU in the cases *Pizzarotti* (*C-558/19*) and *Hornbach* (*C-382/16*) – that the conditions, which do not comply with the arm's length principle, were agreed upon commercial reasons resulting from the status as a shareholder of the foreign group company.

Notably, the conclusions reached by the Italian Supreme Court with this judgment are consistent with the CJEU case-law related to the different (but strictly connected) matter of the compatibility of national transfer pricing rules with the EU fundamental freedoms, more specifically with the freedom of establishment. In the case at issue, it remains for the taxpayer to prove that the commercial rationale put forward can be considered as an acceptable commercial justification for the purposes of Italian transfer pricing laws.

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Spain – National Court decision on the interpretation of the anti-abuse provision clause of the Spanish non-resident Income Tax Act

On 21 May 2021, the Spanish National Court delivered a judgment rejecting the reversal of the burden of proof established in the anti-avoidance provision of the Spanish non-resident Income Tax Act (NRITA) and thus, correcting the doctrine of the Spanish Central Administrative Tribunal (SCAT), an administrative body. The SCAT has repeatedly applied the CJEU's doctrine from the Danish beneficial ownership cases to Spanish cases thereby denying the tax exemption on dividend payments to EU parent companies in cases where the recipient does not qualify as the beneficial owner if the recipient of the dividend did not demonstrate valid economic reasons.

The wording of the NRITA anti-avoidance provision applicable at the time of the facts addressed in the SCAT rulings stated that the tax exemption on dividends paid would not be applicable in cases where the majority of the voting rights of the parent company are held, directly or indirectly, by natural or legal persons who do not reside in Member States of the EU, except when one of three conditions was met:

- the EU parent company receiving the dividends carried on a business activity directly related to the business activity of the Spanish subsidiary;
- the business purpose of the EU parent company was to manage the subsidiary, with the necessary human and material means; or
- the EU parent company proved that it was incorporated for valid economic reasons and not to gain access to the dividend withholding tax exemption in a fraudulent way.

By applying the CJEU's judgments in *Equiom* (*C-6/16*) and *Deister Holding* (*C-504/16*) stating that the finding of a wholly artificial arrangement requires, on a case-by-case basis, an overall assessment of the relevant situation, the Spanish National Court rejects the application of the abovementioned third condition of the Spanish anti-avoidance clause, since it implies the reversal of the burden of proof, by imposing on the taxpayer the obligation to demonstrate valid economic reasons for the incorporation of the EU parent company. On the contrary, the Spanish National Court requests that, in order to deny the tax exemption on dividends paid to foreign companies, the Spanish tax authorities prove that no valid economic reasons justify the incorporation of the EU parent holding company. This interpretation is also applicable to the present wording of the NRITA's anti-avoidance provision.

The Spanish National Court's judgment can be appealed to the Spanish Supreme Court, which is to state the final doctrine on this issue.

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Spain – Supreme Court confirms validity of the Spanish tax on the value of electricity production

In December 2012, Law 15/2012 on fiscal measures for sustainable energy introduced the tax on the value of electricity production (TVEP) which is levied on the activities of production and incorporation of electricity into the Spanish electricity system. The tax was contested by the affected electricity producers based on its alleged unconstitutionality and incompatibility with various EU Directives.

After two resolutions by the Spanish Constitutional Court that rejected a breach of the Spanish Constitution, and the CJEU's Judgment of 3 March 2021, *Promociones Oliva Park* (*C-220/19*), that confirmed the compatibility of the TVEP with EU Law, the Spanish Supreme Court handed down judgment on 1 June 2021 putting an end to the disputes on the validity of the tax.

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Spain – Spanish transposition of DAC6 completed

Royal Decree 243/2021, dated 6 April 2021, was published in the Official State Gazette on 7 April 2021. This Royal Decree represents the second and final milestone in the transposition of DAC6 into Spanish Law. Together with the publication, the Spanish tax authorities published a few documents in connection with these new tax obligations:

- Order HAC/ 342/ 2021, dated 12 April 2021, was published in the Official State Gazette on 13 April 2021, approving the report forms that must be used by intermediaries or taxpayers to fulfill their reporting obligations (forms 234, 235 and 236);
- Resolution dated April 8, 2021, approving the templates to inform intermediaries or taxpayers that are not required to file the forms (because the filing has been made by other intermediaries or taxpayers, respectively), or to inform about intermediaries' professional secrecy;
- FAQs clarifying certain aspects of the DAC6 obligations; and
- Technical manual on the reporting forms.

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Spain – New Spanish Digital Services Tax guidelines

The Spanish Tax Law on Certain Digital Services, which entered into force on 16 January 2021, has been developed through Royal Decree 400/2021, of 8 June 2021, which clarifies recordkeeping obligations for taxpayers and how to determine the location of user devices. The Spanish Digital Services Tax (DST) is limited to taxing only the following services, which for the purposes of the Spanish Law are identified as "Digital Services": (i) online advertising services, (ii) online intermediation services, and (iii) transfer of data. Certain transactions are not subject to tax, such as digital services between companies of the same wholly owned group.

The tax will be levied at the rate of 3 percent and it applies to legal persons and entities, whether they are established in Spain, in another Member State of the EU, or in any other state or jurisdiction not belonging to the EU that, at the beginning of the settlement period, exceed the following two thresholds: (1) annual worldwide revenues of at least €750 million, and (2) annual revenues that exceed €3 million derived from transactions subject to the Spanish DST.

The decree provides that taxpayers subject to the DST will be obligated to keep the records, submit for each quarterly settlement period, or at the request of the Administration, information related to its digital services and establish the systems, mechanisms or agreements that allow for the determination of the location of the users' devices in the territory of application of the tax.

The first and second quarters of 2021 must be self-assessed and paid no later than 2 August 2021 through form 490.

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EU Developments

EU – European Commission publishes Communication on Business Taxation for 21st Century

On 18 May 2021, the European Commission published a Communication on EU Business Taxation for the 21st Century in which it sets out its vision and measures for both the short and longer term. This initiative reflects the European Commission's efforts to create what it sees as a future-proof, robust, efficient, and fair EU tax framework that meets public financing needs and supports the COVID-19 recovery effort and the green and digital transitions by creating an environment conducive to fair, sustainable and job rich growth and investment. The Communication states that the European Commission wants to act swiftly to implement the forthcoming global agreement on the reallocation of taxing rights and minimum effective taxation. The European Commission will take action over the next two years to address the most immediate challenges and set out a plan for a 'holistic EU business tax framework fit for the decades to come'. The European Commission outlines a range of new measures, including:

- *Implementing Pillars 1 and 2 in the EU*

The European Commission will propose Directives for implementing Pillars 1 and 2 in the EU. According to the European Commission, the implementation of a global agreement on minimum effective taxation will also have implications for existing and pending EU Directives and initiatives. The European Commission will also propose adding Pillar 2 to the criteria for assessing third countries for the EU list of non-cooperative jurisdictions to incentivise them to join the international agreement. The European Commission will revive its pending proposal to include a subject-to-tax-rule in the Interest & Royalty Directive.

- *A legislative proposal to address aggressive tax-planning opportunities linked to the use of shell companies ('ATAD 3')*

The European Commission will present a draft Directive in Q4 2021 that will require companies in the EU to report to the tax administration the necessary information to assess whether they have substantial presence and real economic activity and deny tax benefits linked to the existence or the use of abusive shell companies. The proposal will also introduce new tax information, tax monitoring and tax transparencyrequirements. The European Commission intends to take further steps to prevent that royalty and interest payments leaving the EU escape taxation ('double non-taxation'). The European Commission published an inception impact assessment on 20 May 2021 for feedback followed by a public consultation open until 27 August 2021.

- *A legislative proposal for a Debt Equity Bias Reduction Allowance ('DEBRA')*

The European Commission will present a draft Directive in Q1 2022 to address the debt-equity bias in corporate taxation via an allowance system for equity financing and stimulate the re-equitisation of financially vulnerable companies. The European Commission will incorporate anti-abuse measures to ensure it is not used for unintended purposes.

- *A legislative proposal for the annual publication of Effective Tax Rates paid by large companies operating in the EU*

This will be based on the methodology under discussion at the OECD negotiations for Pillar 2. This proposal is expected in 2022 and aims to improve public transparency around the 'real' effective tax rate experienced by large EU companies.

- *Business in Europe: Framework for Income Taxation ('BEFIT')*

This proposal (for 2023) will:

- combine a common rulebook for the tax base with a 'simpler and fairer' way to allocate taxing rights between EU Member States via formulary apportionment;
- reduce red tape and cut compliance costs in the Single Market for tax authorities and taxpayers;
- combat tax avoidance, and support job creation, growth, and investment;
- ensure reliable and predictable corporate tax revenues for EU Member States;
- replace the pending proposals for a Common Consolidated Corporate Tax Base (CCCTB), which will be withdrawn; and
- be prepared in close cooperation with the EU Member States, also taking into account the views of the European Parliament, and in consultation with the business sector and civil society groups.

- *New EU Own Resources*

In line with the mandate from the European Council, the European Commission will also bring forward proposals for new Own Resources that will contribute to the repayments of NextGenerationEU. The European Commission planned to propose in July 2021 a Digital Levy, which according to the European Commission will be compatible with the key policy objective of supporting and accelerating the digital transition and with WTO and international obligations. The Commission states that the Digital Levy will be independent of the expected upcoming global/OECD agreement on international tax reforms and coexist with it once adopted. The 2018 European Commission proposals for a Digital Services Tax and Significant Digital Presence will be withdrawn. The proposal for a Digital Levy was deferred beyond July 2021.

The European Commission also planned to propose new and reformed pricing mechanisms to support EU climate objectives, namely an EU Carbon Border Adjustment Mechanism (CBAM) and a proposal for a revised EU Emissions Trading System (ETS), as EU Own resources. These also aim at supporting the green transition, together with the planned reform of the Energy Taxation Directive. The European Commission has indicated it will propose other EU Own Resources which could include a Financial Transaction Tax and an Own Resource linked to the corporate sector.

Recommendation to EU Member States on the domestic treatment of losses for SMEs

Besides the Communication, the European Commission issued a Recommendation to EU Member States on the domestic treatment of losses for SMEs during the COVID-19 recovery to allow companies that were making a profit and paying taxes prior to 2020 to offset their 2020 and 2021 losses against these taxed profits.

Broader reflection on the future of the EU's tax system

The European Commission will launch a broader reflection on the future of the EU's tax system, which will culminate in a Tax Symposium on the 'EU tax mix on the road to 2050' in 2022.

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EU – Council and European Parliament reach provisional political agreement on EU public country-by-country reporting for big multinational groups

On 1 June 2021, negotiators for the European Parliament and the Portuguese EU Council Presidency, on behalf of the Council of the EU (EU-27 Member States), with the European Commission present as well, provisionally reached a compromise agreement on EU public country-by-country reporting ('Public CbCR') for big multinational groups.

This provisional political agreement, once endorsed, will require multinational groups or standalone undertakings with a total consolidated revenue of at least €750m, in that and the previous financial year, whether headquartered within the EU or not, to publicly disclose the corporate income tax they pay in each EU Member State plus in each of the countries that are listed in Annex I of the EU list of non-cooperative jurisdictions for tax purposes ('the EU's blacklist') or listed for two consecutive years in Annex II (the 'EU's grey list'). There is a de minimis for groups with only a small footprint in the EU.

Per the provisional political agreement the public disclosures, which cover income tax accrued, revenues, employees and more, must follow a common EU-template and be presented in a machine-readable electronic format.

The reporting is required within 12 months from the date of the balance sheet of the financial year in question. In-scope companies will first need to make a report, at the latest, in relation to the first financial year starting on or after one year after the transposition deadline. EU Member States will have (up to) eighteen months after the Public CbCR Directive's entry into force to transpose the Directive into domestic law.

The EU's Public CbCR Directive will set out the conditions under which a company may obtain deferral of disclosure of certain elements for a maximum of five years. It will also stipulate who bears the actual responsibility for ensuring compliance with the reporting obligation.

The related EU Council press release stated that in order to avoid disproportionate administrative burden on the companies involved, and to limit the disclosed information to that absolutely necessary to enable effective public scrutiny, the EU Public CbCR Directive provides for a complete and final list of information to be disclosed.

The European Commission will review the application of the Directive four years after the transposition date. See also PwC's tax policy bulletin for more information.)

On 9 June 2021, the EU's 27 Member State Permanent Representatives to the EU (COREPER) adopted the provisionally agreed compromise text on behalf of the Council. On 14 June 2021, the European Parliamentary Committees on Economic and Monetary Affairs (ECON) and Legal Affairs (JURI) also endorsed the provisional agreement. The next step is that the European Parliament as a whole (plenary) needs to approve the Council's position which is expected during September 2021, after which the new EU Directive will be deemed adopted and published in the Official Journal of the EU.

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EU – European Commission announces launch of the European Tax Observatory

On 1 June 2021, the European Commission announced the launch of the European Tax Observatory*:* a new research advisory group to assist in the EU's fight against tax abuse. Paolo Gentiloni**,** Commissioner for Economy, hosted the launch event together with Paul Tang, Chair of the European Parliament's Subcommittee on Tax Matters (FISC), and Sven Giegold, Member of the European Parliament, which was followed by a joint press conference.

The European Tax Observatory was created under the initiative of the European Parliament. Funded by the EU and headed by Professor Gabriel Zucman at the Paris School of Economics, the European Tax Observatory strives to be a source of new ideas for combating tax avoidance and an international reference for the study of taxation in a globalised world. The European Tax Observatory is a consortium of academics awarded an EU grant budget of €1.2 million for 2020-21 to deepen the research on tax avoidance, tax evasion, and aggressive tax planning and advise EU policymakers accordingly. Gabriel Zucman is a French economist and Associate Professor of Economics at the University of California, Berkeley, who is known for his research on tax havens and corporate tax havens. His research focuses on the accumulation, distribution, and taxation of global wealth.

European Tax Observatory press conference

- Remarks by Gabriel Zucman, *Director of the EU Tax Observatory*
- Remarks by MEP Paul Tang, *Chair of the Subcommittee on Tax Matters (FISC) of the European Parliament*
- Remarks by MEP Sven Giegold, *Member of FISC*
- Press conference Q&A session

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EU – June 2021 ECOFIN 6-monthly progress report on taxation in the EU

The outgoing Portuguese EU Council Presidency prepared the regular 6-monthly ECOFIN Council progress report on taxation for the EU's heads of state and government (European Council). The report was formally approved by the Council on 18 June 2021 and is divided into three main sections: Initiatives in the area of EU tax law, Administrative cooperation and Tax Policy Coordination.

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EU – June 2021 Code of Conduct Group (Business Taxation) Report to the ECOFIN Council

Also formally approved on 18 June 2021 was ECOFIN's 6-monthly Code of Conduct Group (Business Taxation) Report to the Council. This report from the Code Group encompasses its work in the first half of 2021 during the term of the Portuguese Presidency of the Council.

The report is accompanied by country assessments for Croatia, Lithuania, Poland, and Romania:

- Croatia's reduction of the tax rate for small and mid-sized taxpayers
- Croatia's reduction of withholding tax rate on dividends and profit sharing
- Croatia's determination of tax-deductible expenses of credit institutions for write-offs of receivables from citizens and entrepreneurs
- Croatia's extension of the scope of application related to non-authentic arrangements
- Lithuania's holding company regime
- Poland's notional interest deduction regime – Introduction of an anti-abuse measure
- Romania's reduction of the corporate income tax due
- Romania's exemption from payment of the tax for the taxpayers carrying out specific activities in the HORECA sector.

-- Bob van der Made, PwC Netherlands; bob.vandermade@pwc.com

Sweden – European Commission questions Swedish related party interest deduction limitation rules

Over the years, Sweden has gradually limited the corporate sector's deductibility of interest costs on related party debt. Earlier this year, in the so-called *Lexel* case (*C-484/19*), both the CJEU and the Swedish Supreme Administrative Court (SAC) found it incompatible with the freedom of establishment to deny a Swedish company a deduction for interest on a loan from a French group company. The deduction therefore was granted under EU law.

The rules tried in the *Lexel* case applied during 2013-2018. The rules were amended and replaced in 2019. In simplified terms, a deduction on a loan from a related entity resident in the European Economic Area (EEA) can be denied under the 2019 rules only if the debt relationship is deemed to have been put in place "exclusively or almost exclusively in order for the group to get a substantial tax benefit". The preparatory works refer to statements in the 2013 rules. Back then, it was stated that a substantial tax benefit cannot arise in the case of a loan between two Swedish companies which can consolidate for tax purposes (using the Swedish group contribution rules). The Swedish government is of the view that the 2019 rules are compatible with EU law, but also noted that the phrase "exclusively or almost exclusively" is not intended to target only so-called "wholly artificial situations". A deduction could be denied even in other situations, depending on the circumstances.

On 9 June 2021, the European Commission sent a letter (INFR (2013) 4206) to the Swedish government. The European Commission considers that the 2019 set of rules, in a similar fashion as with the 2013 rules, are incompatible with EU law. The European Commission takes the view that it seems as if the interest deduction limitations could be incompatible with the freedom of establishment in cases where the interest is paid to a company resident in another EU or EEA State.

In the European Commission's view, the limitation is in practice only applicable in cross-border situations and the negative treatment is not justifiable by any overriding public reason. Interest deductions are still denied on loans between related parties resident in the EU/EEA, and even if the loans have arm's length terms. The European Commission therefore concludes that the 2019 rules do not seem to eliminate the infringement of the freedom of the establishment that the 2013 set of rules resulted in. The European Commission has urged the Swedish government to comment on the letter within two months. If the comments are not satisfactory, the EC may initiate proceedings against Sweden on this matter.

The European Commission's views can hardly come as a surprise considering the CJEU's view in *Lexel*. Especially so considering the statements made in the 2019 preparatory works. One case in respect of the 2019 rules is already pending in the SAC and the EU law matter might be addressed already in this case. In the underlying ruling the majority of the Advance Tax Ruling Board, with some hesitation, concluded that a deduction should be granted on a loan from an Irish group company. The interest income was taxed with the 12.5 percent tax rate and was not offset against tax losses. The minority, however, concluded otherwise and in addition found the denied deduction to be in line with EU law. It is worth noting, however, that the ruling was issued one week before the CJEU ruled in *Lexel*. Depending on how the SAC assesses the matter, the EU angle could come up on the table already in this case.

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EU Fiscal State Aid Developments

EU – General Court of the EU annuls European Commission's Amazon State aid decision

On 12 May 2021, the General Court of the EU (General Court) rendered its judgments (joined cases *T-816/17 and T-318/18*) regarding the action brought by Amazon group companies and Luxembourg against the final State aid decision of the European Commission of 4 October 2017 (SA.38944).

In 2014, the European Commission had launched an investigation into a ruling issued by the Luxembourg tax authorities to a Luxembourg tax resident company of the Amazon group in 2003, and prolonged in 2011. According to the facts as described in the decision, during the period under scrutiny (until 2014), Amazon EU Sarl (AEU) functioned as the European headquarter of the group and principal operator of Amazon's European online retail and services business, in charge of strategic decisions related to the retail and services business carried on through the group's EU websites. In order to carry out its operations, AEU used rights under a license agreement for intellectual property (IP) rights from Amazon Europe Holding Technologies (AEHT), a Luxembourg partnership. Its functions were to hold the IP and participate in the development of that IP under a cost-sharing arrangement with Amazon US.

Under the transfer pricing analysis carried out at the time when the ruling was obtained, the royalty that AEU paid to AEHT was determined based on the residual profit split method. The transfer pricing report explained why this method was preferable over the comparable uncontrolled price method (CUP) which was also analyzed.

In its decision, the European Commission concluded that Amazon received an individual selective advantage in the form of the tax ruling because it set a transfer pricing result and methodology that was found by the EC to be not in line with the arm's length principle.

The General Court stated first that, when examining a fiscal measure granted to an integrated company, the European Commission may compare the tax burden of that undertaking with the tax burden resulting from the application of the normal rules of taxation under national law of an undertaking, placed in a comparable factual situation, carrying on its activities under market conditions.

Then, the General Court pointed out that the European Commission can demonstrate the existence of an advantage in examining the transfer pricing methodology used for an integrated company's taxable income only if the remuneration applied leads to a reduction in the taxable profit of the company compared with the tax burden of a standalone undertaking transacting on the open market subject to the application of the normal taxation rules.

In the case at hand, the General Court concluded that the European Commission did not sufficiently demonstrate the existence of an advantage on the following grounds:

- The European Commission relied only on its own functional analysis of AEHT and did not demonstrate that the Luxembourg tax authorities had incorrectly chosen AEU as the tested party in order to determine the amount of the royalty.
- The European Commission did not establish the existence of an advantage because the "arm's length" remuneration proposed by the European Commission could not be solely calculated on the basis of the mere passing on of development costs of the intangible assets to AEHT without taking into account the increase in value of its intangible assets.

- The European Commission was wrong to ascertain the remuneration of AEHT on the basis of the supply of "low value adding" services.
- The European Commission failed to prove the undervaluation of the remuneration of AEU and did not justify to the requisite legal standard the methodological choice in light of the functions of AEU.

The General Court provided in this decision important clarifications regarding the scope of the European Commission's burden of proof in establishing the existence of an advantage where the level of taxable income of an integrated company belonging to a group is determined by the choice of the transfer pricing method. The European Commission have appealed the judgment.

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EU – General Court of EU confirms European Commission's final decision in the GDF Suez (now Engie) State aid case

On 12 May 2021, the General Court of the EU (General Court) rendered its judgments (joined cases *T-516/18* and *T-525/18*) regarding the action brought by Engie group companies and Luxembourg against the final State aid decision of the European Commission of 20 June 2018 (SA.44888).

The European Commission investigation was related to rulings issued by the Luxembourg tax authorities between 2008 and 2014, which were confirming the tax treatment of certain mandatorily convertible instruments (the "instruments") issued by two Luxembourg group subsidiaries ("borrowers") to two other Luxembourg companies of the Group ("lenders").

The rulings were confirming the following tax treatment:

- the borrowers treated the instruments as debt and recorded in their accounts accretions which were deductible at their level;
- the lenders entered into a forward sale agreement with a third entity with the receipt being subject to a participation exemption

In its decision, the European Commission considered that the rulings granted State aid by incorrectly lowering the tax basis of the Luxembourg companies.

More specifically, the European Commission decision argued that the rulings endorsed an inconsistent treatment of the same amounts as representing deductible expenses on the instruments at the level of the borrowers and income exempt under the domestic participation exemption at the level of the creditors.

The General Court approved the European Commission's approach of analyzing this intra-group financing structure by looking at its final economic result, disregarding the specific tax treatment applicable under the Luxembourg law at the time for each individual transaction.

For the General Court, these transactions were designed to be implemented in three successive but interdependent stages achieving a single economic result.

The General Court considered that the European Commission was entitled to determine that the combined effect of the transactions derogated from the reference framework and represented a selective advantage because the lenders were allowed to benefit from the provisions of the Luxembourg domestic participation exemption on amounts which corresponded from an economic perspective to deductible expenses incurred by the borrowers in relation to the instruments.

In a secondary line of argument, the European Commission ascertained in their interpretation that the criteria laid down by Luxembourg law in order to determine the existence of an abuse of law were met and hence the group of companies received preferential tax treatment owing to the non-application in the rulings of the provision relating to the abuse of law.

In the light of the objective pursued by the provision relating to abuse of law, namely to combat abusive practices in tax matters, the General Court considered that the holding companies were in the same factual and legal situation as Luxembourg taxpayers that cannot reasonably expect to benefit from the non-application of the abuse of law provisions in cases where the conditions for its application (in the interpretation of the General Court) have been satisfied and hence the holding companies benefitted from a selective advantage.

On this basis, the General Court concluded on the existence of State aid under article 107 TFEU.

This decision is of importance because it confirms for the first time that the European Commission can determine the existence of a selective advantage for state aid purposes on the grounds of non-application of a local concept of abuse of law by the local authorities. The judgment has been appealed.

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EUDTG is PwC's pan-European network of EU law experts. We specialise in all areas of direct tax, including the fundamental freedoms, EU directives and State aid rules. You will be only too well aware that EU direct tax law is moving quickly, and it's difficult to keep up, but it is crucial that taxpayers with an EU/EEA presence understand the impact. See for more info: www.pwc.com/eudtg or contact bob.vandermade@pwc.com