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EU Tax News

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CJEU Cases

Belgium – CJEU judgment in X concerning the Belgian Fairness Tax

On 17 May 2017, the CJEU rendered its judgment in *X* (C-68/15). The judgment concerns a Belgian company which in 2014 filed an action for annulment of the so-called Belgian Fairness Tax with the Belgian Constitutional Court, which referred preliminary questions to the CJEU on 28 January 2015. On 17 November 2016, AG Kokott issued her opinion on the preliminary questions.

The Belgian Fairness Tax is applicable when companies have distributed dividends during the taxable period and their taxable profit has been partly or fully offset against notional interest or they have carried forward tax losses. A complex calculation determines the taxable basis. The tax rate is set at 5.15%. The Fairness Tax applies to Belgian companies and to Belgian branches of foreign companies. For the Fairness Tax to be compliant with EU law, the tax treatment of non-resident companies conducting their activities in Belgium through a permanent establishment (PE) should not be less advantageous than that of resident companies. According to the CJEU a less advantageous treatment of non-resident companies results from the application of the Fairness Tax due to the apportionment rule laid down in Article 233(3) of the Belgian Income Tax Code (BITC). This rule is applicable towards profits falling outside the scope of the Belgian tax jurisdiction (i.e. profits which cannot be attributed to a Belgian PE pursuant to the relevant treaties for the avoidance of double taxation). The CJEU considered that the Belgian legislation as a consequence infringes EU law.

It can be argued along the same lines however that applying the Fairness Tax to the profits of a Belgian PE, which have not been repatriated to its head office (and distributed by the head office in the same year), also constitutes a less advantageous treatment compared to resident companies. This is because a Belgian company is only taxed on its dividend distribution while a Belgian PE can be subject to the Fairness Tax even if does not repatriate profits to its head office). However, the CJEU did not address this particular point.

The CJEU also confirmed that the Fairness Tax cannot be regarded as a withholding tax within the meaning of the Parent-Subsidiary Directive (PSD) and therefore does not infringe on Article 5 PSD. As part of the implementation of the PSD in Belgium, an amount comprising 95% of the qualifying dividends received is exempt from (non-resident) corporate income tax. The remaining 5% is in principle subject to tax based on the implemented Article 4(3) of the PSD. However, in the typical case of an intermediary holding company, the complexity of the taxable basis leads to situations where the Fairness Tax applies to more than 5% of qualifying dividends received and redistributed by the intermediary. In those cases the CJEU followed the AG's opinion, and considered the Fairness Tax to infringe Article 4(3) of the PSD. See also the item in this newsletter on the CJEU's judgment on the same day on the French contribution tax.

The Belgian Constitutional Court still needs to rule on several arguments dealing with aspects of Belgian constitutional law (the principles of legality and equal treatment) and with treaties for the avoidance of double taxation. This case can therefore still take some time before it is settled.

Based on the above, companies operating in Belgium (either Belgian companies or Belgian PEs of foreign companies) that have paid the Fairness Tax are advised to consider safeguarding their rights.

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Belgium – CJEU judgment in Van der Weegen and Pot concerning the tax exemption applicable to income from savings deposits

On 8 June 2017, the CJEU rendered its judgment in *Van der Weegen and Pot* (C-580/15). This case, which concerns the tax treatment of Belgian as opposed to non-Belgian savings deposits, was referred to the CJEU by the Court of First Instance of Bruges. The Belgian tax authorities had refused to apply the tax exemption applicable to interest income received from Dutch savings deposits held by individuals, claiming that the conditions for the exemption laid down in Belgian law were not fulfilled.

The tax exemption is applicable without distinction to income from savings deposits held with banking service providers established in Belgium or in another Member State or the EEA insofar as the foreign savings deposit system is comparable to the Belgian system. However, to the extent that this system imposes conditions on access to the Belgian market on service providers established in other Member States, there can be an infringement of the freedom to provide services. In 2013, the CJEU already established that because the tax exemption was only applicable to deposits held with a Belgian bank, the system was discriminatory and violated the freedom to provide services (C-383/10) As a result, the exemption was extended to credit institutions established in the EEA provided that the non-Belgian deposits comply with similar conditions as the Belgian deposits. For instance, the remuneration received on the savings deposits must consist of basic interest and a fidelity premium.

However, it appears that this method of remuneration is specific to the Belgian banking market. The CJEU held that the Belgian tax exemption has the effect of discouraging Belgian residents to use the services of banks established in other Member States and open or keep savings accounts with those latter banks, since the interest paid by those banks cannot benefit from the tax exemption, in particular because of the required remuneration method.

Secondly, the CJEU held that the Belgian legislation effectively discourages holders of a savings account with a bank established in Belgium, which complies with the exemption conditions, to transfer their account to an EEA bank whose savings accounts do not meet those conditions.

The CJEU ruled that the Belgian legislation is capable of constituting an impediment to the freedom to provide services to the extent that it imposes conditions on access to the Belgian banking market on service providers established in other Member States. However, the CJEU added that whether or not this is the case is a matter for the referring national court to verify. The CJEU also ruled that consumer protection cannot be invoked as a justification since the Belgian legislation does not comply with the principle of proportionality.

It is up to the national court to decide whether the Belgian tax exemption imposes extra conditions on access to the Belgian banking market on non-Belgian service providers. This implies that it is uncertain whether the freedom to provide services is effectively infringed in this case, although it is to be expected that the national court will rule in favour of the taxpayer. If that is indeed the case then Belgium will need to reform its exemption regime for savings deposits again.

In anticipation of the final outcome of this case, Belgian individuals holding savings accounts in an EEA Member State may consider applying the interest exemption when filing their personal income tax return. The maximum interest threshold for assessment year 2017 (income year 2016) amounts to EUR 1,880. Interest income from qualifying savings deposits exceeding this threshold is taxable at a rate of 15%.

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France – CJEU judgment in AFEP concerning the French contribution tax

On 17 May 2017, the CJEU rendered its judgment in *Association française des entreprises privées (AFEP)* (C-365/16) holding that the liability of a French company for the 3% contribution on dividends, which are redistributed from its subsidiaries established in another EU Member State, is incompatible with the Parent-Subsidiary Directive (PSD) as it creates double taxation of profits made within the EU, which is prohibited by the said directive.

The 3% contribution applies to dividend distributions and deemed dividend distributions (according to French law) made by companies subject to corporate income tax. Challenged as early as its first year of application, the 3% contribution has been the subject of numerous administrative and judicial litigation procedures. This has culminated in a series of decisions of the French administrative Supreme Court issued on 27 June 2016 on the constitutionality of the law and also its compatibility with the PSD. The French administrative Supreme Court therefore referred a preliminary ruling to the CJEU about the compatibility of the 3% contribution with Articles 4 and 5 of the PSD.

As regards the answer to the first question, Article 4(1) of the PSD – which seeks to avoid double taxation of profits received by a parent company from its EU subsidiaries established in another Member State of the EU - allows Member States to choose between a mechanism of exemption or taxation with a tax "offsetting mechanism". Since France has elected for the first option, it shall refrain from taxing distributions falling within the scope of the PSD (apart from the possibility of reinstatement of a 5% flat-rate charge and expenses).

The CJEU held that the basis of the 3% contribution, consisting of dividends distributed by companies subject to corporation tax in France, can also include profits received from subsidiaries established in other Member States. Therefore, the CJEU considers that France disregards Article 4 of the PSD insofar as the 3% contribution results in the taxation of the dividends at least for a second time. The CJEU dismissed the argument put forward by France that Article 4(1)(a) of the PSD is applicable only where a parent company receives profits distributed by its subsidiary. According to the CJEU, the latter interpretation does not follow either from the wording of that provision or the context or aims thereof. It dismissed the argument put forward by France that this provision is applicable only at the stage of the collection of profits and not at the stage of redistribution, by a literal reading of the directive corroborated by a teleological interpretation.

The CJEU did not rule on the second question concerning the characterization of the 3% contribution as a withholding tax which is prohibited by Article 5 of the PSD. It is, however, interesting to note that in its judgment on the Belgian Fairness Tax (C-68/15), delivered on the same day (see item elsewhere in this newsletter), the CJEU refused to qualify the Belgian Fairness Tax – which is similar to the French 3% tax, as a withholding tax. Indeed, the liable person is the distributing company and not the shareholder.

This judgment of the CJEU is important with regard to disputes relating to the 3% contribution but it is only one step. It can be expected that litigation will continue on aspects of French constitutional law. Indeed, at this stage, the CJEU's decision prohibits the levying of the contribution on the redistribution of profits made by EU subsidiaries but does not prohibit the taxation of redistributions of profits by subsidiaries resident in France or in a third (i.e. non-EU) country to the European Union. The issue of a potential discrimination (i.e. when a domestic situation or a situation involving a third country is treated less favourably than an EU situation), should therefore be at the heart of the appeals before the administrative Supreme Court and probably before the Constitutional Council.

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Luxembourg – CJEU judgment in Berlioz concerning exchange of information upon request

On 16 May 2017, the CJEU rendered its judgment in *Berlioz Investment Fund SA* (C-682/15). This case, which concerned exchange of information upon request between tax administrations, was referred to the CJEU by the Luxembourg Administrative Court. The main issue at stake was whether national courts of a Member State which are asked to provide information are allowed to review the foreseeable relevance of the requested information for other Member States.

In 2014, the French tax administration sent a request for information to Luxembourg concerning the activities of Berlioz pursuant to Directive 2011/16/EU on Administrative Cooperation (the Directive). Following this request, the Luxembourg tax administration adopted a decision requesting Berlioz to submit the requested information. Berlioz however provided only part of the information on the grounds that some of the information was not foreseeably relevant within the meaning of the Directive for the tax issue being reviewed by the French tax administration. The Luxembourg tax administration imposed a EUR 250,000 administrative fine on Berlioz for failing to provide part of the requested information. The applicant contested the fine before the Luxembourg courts on the ground that the information request did not meet the foreseeable relevance criterion and was therefore invalid. Under the applicable Luxembourg law, the information holder may challenge the amount of the fine but there is no possibility to challenge the information request *per se*. The Administrative Court of Luxembourg referred six questions to the CJEU regarding the foreseeable relevance criterion as well as the applicability of the Charter of Fundamental Rights of the European Union (Charter) to the case at hand.

First, the CJEU reiterated that the Charter is applicable when Member States implement EU law. Even if the Directive does not make an express reference to penalties, their imposition for a failure to comply with the Directive is to be regarded as involving its implementation. Second, Article 47 of the Charter (right to an effective remedy and to a fair trial) must be interpreted as meaning that an information holder on whom a sanction has been imposed for failure to comply with an information request is entitled to challenge the legality of the information request. Third, the foreseeable relevance of the requested information is a condition that must be fulfilled in order for the information request to be considered valid and for the subsequent penalty for failure to comply with such request. The national courts of the requested Member State have jurisdiction to verify that the information request is not devoid of any foreseeable relevance.

The CJEU highlighted that the case at hand must be distinguished from *Sabou* (C-276/12), where it concluded that the taxpayer who was the subject of the investigation had no right to be informed or involved in the process of the information request. At the level of the taxpayer, information gathering is considered a preliminary phase, which has to be distinguished from the contentious phase.

Based on this judgment, Member States have to ensure that information holders fined for failing to comply with an information request will have the possibility to challenge the validity of such request, including to some extent its foreseeable relevance for the investigation in the requesting Member State. As noted above, the Charter applies to exchange of information under the Directive. In many cases, a bilateral tax treaty may also be used as a legal ground for an information request (including between Member States). For these requests, it remains to be seen whether a similar result could be achieved through Article 6 of the Convention for the Protection of Human Rights and Fundamental Freedoms.

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National Developments

Austria – Administrative High Court disallows import of foreign (final) losses despite transfer of place of management

In its decision of 29 March 2017 (Ro 2015/15/0004), the Austrian Administrative High Court (VwGH) clarified that losses incurred abroad may not be taken into account even after the place of management has been transferred to Austria.

S-GmbH, a German limited liability company operating exclusively in Germany in 2002 and 2003, ceased its operations there in 2004 and transferred its place of management to Austria. Despite the fact that the company's operational activities were entirely transferred to Austria, its German legal seat was maintained until 2011 when the German company was finally merged with an Austrian corporation. In 2008 and 2009, S-GmbH tried to use the German losses incurred in 2002 and 2003 in Austria. This was denied by the Austrian national tax office. The subsequent appeal was dismissed by the Federal Fiscal Court (FFC), which rejected the taxpayer's legal arguments relating to the non-compliance of Austrian national law with the freedom of establishment contained in Article 49 TFEU. Moreover, the losses incurred by the company were not considered to be final.

The appeal was also rejected at the level of the Austrian VwGH, which held that Austrian national law does not constitute a breach of EU law. According to the VwGH, it clearly follows from the judgment of the CJEU in *Futura Participations SA and Singer* (C-250/95) that Article 49 TFEU does not preclude a Member State from making the carry forward of previously incurred losses, requested by a taxpayer which has a branch in its territory but is not resident there, conditional on the losses being economically related to income earned by the taxpayer in that Member State. However, this is not the case for the disputed losses since they were generated via a German permanent establishment at a time when the company was not subject to Austrian taxation. Moreover, the Austrian VwGH rejected the comparability of a resident company with a non-resident company therefore rendering the use of German losses in Austria impossible. Factually, this means that the disputed losses in the case at hand would not be taken into account in Austria even if they were considered to be final losses.

In the case at hand, due to a lack of comparability, the existence of potential final losses was considered irrelevant and the importation of German losses due to a transfer of the place of management was rejected categorically. This appears to be in line with the approach recently adopted by the CJEU in *Timac Agro* (C-388/14). Since the jurisprudence in this area is however not uniform, it would have been desirable if the VwGH had referred this case to the CJEU for a preliminary ruling.

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Germany – Federal Fiscal Court refers § 6a RETT Act to CJEU as potential State aid

In its decision dated 30 May 2017, the German Federal Fiscal Court expressed its doubts as to the compatibility of the German real estate transfer tax (RETT) exemption, pursuant to § 6a German RETT Act, with the EU's State aid provisions. Therefore, the Federal Fiscal Court referred preliminary questions to the CJEU.

In the underlying case, the plaintiff had been the sole shareholder of a subsidiary holding real estate for more than five years. In 2012, the subsidiary was merged up-stream into the plaintiff. The German tax authorities considered the merger to be a taxable acquisition for which a tax exemption pursuant to § 6a German RETT Act could not be granted. However, the Federal Fiscal Court took the view that § 6a German RETT Act applies to the up-stream-merger of the subsidiary to the plaintiff.

According to the Federal Fiscal Court, it is on the one hand questionable whether the tax exemption under § 6a German RETT Act may be regarded as a measure which is capable of constituting State aid pursuant to Article 107(1) TFEU. In this context, it is necessary to clarify whether § 6a German RETT Act provides for a selective advantage to certain undertakings because it requires:

- a restructuring in the sense of the German Restructuring Act,
- a 95% shareholding between a controlling and a dependent company and
- a minimum holding period of five years before and five years after the restructuring.

On the other hand, the Federal Fiscal Court takes the view that § 6a German RETT Act can be justified by the nature or the general scheme of the tax system as the rule simply carves out certain restructurings from the general definition of taxable events in § 1 German RETT Act, a provision which appears to be too broad as it also includes reorganisations within a group.

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Germany – Federal Fiscal Court denies deduction of final losses according to EU law

In its decision dated 22 February 2017 (case no. *I R 2/15*), the German Federal Fiscal Court essentially followed the CJEU's judgment in *Timac Agro* (C-388/14) thereby denying the deduction of final permanent establishment (PE) losses at the level of the head office. The Federal Fiscal Court based its decision on the argument that a foreign PE that is exempted under a tax treaty is not considered to be comparable to a domestic PE.

The case concerned a loss stemming from a compensation payment made by the transferor to the transferee due to the transfer of the interest in a partnership owning a foreign treaty exempt PE. The parties to the transfer expected the partnership to incur further losses in the following years, which the transferor had to compensate in advance. According to the Federal Fiscal Court, the compensation payment cannot be deducted as a final loss, since the foreign permanent establishment is not comparable to a domestic one. The Court left the question open whether, for example, domestic subject-to-tax-clauses may make a foreign permanent establishment comparable to a domestic PE even if the exemption method is foreseen in the applicable tax treaty. Moreover, it was also not relevant whether the residence state takes the PE profits/losses into account when calculating the progressive tax rate (i.e. in the case at hand, the resident taxpayer was a corporation and therefore not subject to a progressive tax rate in Germany).

With regard to the question of the deductibility of final losses, there are still two cases pending before the Federal Fiscal Court (*I R 17/16* and *I R 18/16*). Case *I R 17/16* deals with the shutdown of an Italian PE by a German head office, whereas *I R 18/16* concerns three Dutch branches that were closed. It remains to be seen whether the Federal Fiscal Court takes a different view in those pending cases.

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Italy – Amendments to the Italian NID and Patent Box Regime: conversion into law with revisions

On 15 June 2017, the Italian Parliament converted into law the Law Decree n. 50/2017 introducing amendments to the Italian rules on Notional Interest Deduction (NID) and the Patent Box regime (see EU Tax News Issue 2017 – nr. 003 for an analysis of the Law Decree prior to being amended by Parliament). According to Italian law, Law Decrees issued by the Government have immediate effect but need to be converted into law by Parliament within 60 days with the possibility of amending the original text. As pertains to the NID regime, the former method for calculating the increase in capital contributions and the corresponding notional interest deduction based on the amount of equity from 31 December 2010 (thus, without the five year limitation rule originally introduced by the Law Decree) was restored. Furthermore, the notional interest rate was further reduced to 1,6% for 2017 (instead of 2,3%) and to 1,5% for 2018 (instead of 2,7%). The Parliament did not modify the proposed amendments to the Italian Patent Box regime.

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Poland – Ministry of Finance publishes warning on aggressive tax planning structures

On 12 June 2017, the Polish Ministry of Finance published a warning concerning structures that may contain indicators of aggressive tax planning. In the publication, the Ministry underlined that under certain circumstances, the tax residence of a foreign company may be shifted to Poland if such company is deemed to be effectively managed from Poland. The warning applies to foreign companies the decision making process of which, including strategic decisions and day-to-day management, is carried out in Poland with the main reason of registration abroad being to avoid paying taxes in Poland. The Ministry warns that such operations do not lead to an effective exemption from taxation in Poland. The Ministry's warning sets forth indicators related to decision making that can be subject to tax control in Poland when determining a company's place of effective of management such as among others: e-mail correspondence; meeting places of management with employees, contractors, advisors, buyers or suppliers; proof of residence of employees; and management and title to the office space.

The warning also provides for a list of indicators pertaining to the management board, employees, documentation and other substance requirements which in the Ministry's view can support that the place of management of a foreign entity might not be located in the country of its registered office. In addition to the decision making process, the tax authorities may also take into account other factors such as: the rationale and purpose of establishing a company in a foreign country, the form of its acquisition and the scope of its operations (whether these are continuous or are carried out only once). According to the warning, the taxation of the income of foreign companies in Poland may be applied retroactively. This is one out of four warnings regarding aggressive tax planning and tax avoidance issued by the Ministry of Finance this year. It is anticipated that the list will expand in the near future.

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Spain – Supreme Court issues preliminary ruling about tax on activities that affect the environment

On 7 June 2017, the Spanish Supreme Court issued a reasoned ruling admitting the appeal filed by a telecommunications company challenging a regional law that established a tax on activities that affect the environment. This tax is determined on the basis of a number of fixed elements of the communications network of the company (turrets, posts, antennas and any other elements) that are not wire connected. The annual tax quota amounts to EUR 700 per fixed element.

The company claimed that the regulation of the tax on activities that affect the environment is in breach of EU Law as it specifically contravenes Articles 12, 13 and 14 of EU Directive 2002/20/CE as well as Articles 107(1), 49, 56 and 191 to 193 of the TFEU and CJEU case law. The Supreme Court concluded that there is a potential breach of Article 107(1) TFEU insofar

as this tax could be considered as unlawful State aid due to its asymmetrical character. The reason is that the tax directly targets mobile telephone providers but expressly excludes fixed telephone providers. Therefore, it is important to determine whether the mobile telephony providers are in direct competition with the fixed telephone providers, which remains to be decided by the Supreme Court in its future judgment. It is likely that the Supreme Court will refer the case to the CJEU requesting a preliminary ruling on this matter.
-- Antonio Puentes and Carlos Concha, PwC Spain; antonio.puentes@es.pwc.com

Switzerland – Federal Council presents basic parameters of the renewed planned tax reform

After the rejection of the original Corporate Tax Reform III (CTR III) in a public vote on 12 February 2017, an amended Swiss corporate tax reform (Tax Package 17) is underway. The basic parameters of the planned reform were confirmed by the Federal Council on 9 June 2017.

Compared with CTR III, the special rules will be drawn up more restrictively and the interests of the cities and communes will carry more weight. The currently proposed measures can be summarized as follows:

- Abolition of the special tax regimes that are no longer accepted internationally (cantonal holding status, taxation as a mixed company or domiciliary company as well as principal status and Swiss finance branches at the federal level),
- Introduction of a patent box meeting the OECD standards at cantonal level,
- Optional additional deduction of 50% for R&D costs incurred in Switzerland (based on R&D salary costs plus a mark-up),
- Statutory provisions in relation to the tax consequences of entering or exiting Swiss tax liability and transitional rules limited to five years when changing from a special regime to ordinary taxation.

Because of the negative reactions prior to the CTR III bill vote, the Federal Council does not foresee the introduction of a deduction for interest on equity at the federal level. Whether there is room for the optional cantonal introduction of an interest deduction on surplus capital is still undecided. The expected date of enactment of Tax Package 17 at Swiss federal level is expected to be 1 January 2019 (or a year later) with the cantonal implementations to be expected as of 1 January 2020 depending on how swiftly the political process can be completed.
-- Armin Marti and Anna-Maria Widrig Giallouraki, PwC Switzerland; armin.marti@ch.pwc.com

United Kingdom – Upper Tribunal Tax and Chancery decision on the Coal Staff Superannuation Scheme Trustees

On 26 April 2017, the Upper Tribunal Tax and Chancery rendered its decision on the Coal Staff Superannuation Scheme Trustees case. The Trustees previously appealed to the First-tier Tribunal for a repayment of UK withholding tax paid in respect of manufactured overseas dividends, which could not be used to offset tax paid, arguing that the withholding tax contravened the free movement of capital under Article 56 EC (currently Article 63 TFEU). The appeal failed.

The Trustees appealed further to the Upper Tribunal (UT). Before the substantive appeal could be heard, they applied for an immediate reference to the CJEU. They argued that as the Government had announced its intention that the UK's exit from the EU should end the CJEU's jurisdiction over the UK, a delay in referring the questions on EU law could result in them being deprived of their ability to seek the CJEU's assistance in resolving their EU law based claim, which could make it excessively difficult to enforce their EU law rights; therefore the referral was necessary at this point, even prior to the UT hearing the appeal. The substantive EU law issue at stake was whether the withholding tax was a prohibited restriction on the free movement of capital.

The test for a reference under the tribunal's discretion based on Article 267(3) TFEU was whether the tribunal was satisfied that without a reference it would not be able to resolve the EU law issue before it. The UT accepted that the appeal raised issues of EU law that were not *acte clair*, and also that the government had publicly indicated its intention to bring to an end the CJEU's jurisdiction over the UK. However, the UT highlighted that transitional provisions to deal with people who at the date of the UK's exit are in the course of litigation to determine issues of directly effective EU law are not yet known. These transitional provisions would need to be applied to litigation on such issues before the Courts at the time of exit and should not be pre-empted. There was no reason to make reference to the CJEU prior to the appeal hearing. The questions to be referred were not yet known. The appeal also raised issues about the effect of the domestic regime, which would need to be resolved first. There was an established body of CJEU case law on Article 56 EC, and the UK courts and tribunals were familiar with applying established principles to new circumstances. The UT was not satisfied that it would not be able to resolve the EU law issue by itself on this basis.

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EU Developments

EU –ATAD II Directive formally adopted

On 29 May 2017, the EU's Council (in the Competitiveness Council configuration) formally adopted the Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries without further discussion. The amended Directive (ATAD II) has a broader scope than ATAD I as it also covers hybrid mismatches with third countries and more categories of mismatches. The formal adoption of ATAD II follows the political agreement reached by EU Member States in the ECOFIN Council on 21 February 2017 and the opinion of the European Parliament issued on 27 April 2017.

During the ECOFIN Council meeting of 12 July 2016, when ATAD I was adopted, a request was put forward for an EC proposal on hybrid mismatches involving third countries as well in order to provide for rules consistent with and no less effective than the rules recommended by the OECD BEPS report on Action 2. The terms and concepts contained in ATAD II are very similar to those in the OECD's BEPS Action 2 recommendation. Explicit mention is made in the preamble of ATAD II to the explanations and examples contained in the OECD recommendation which should be used "as a source of interpretation" insofar as they are consistent with EU law.

As regards the scope, where ATAD I includes rules on hybrid mismatches between Member States, ATAD II adds rules on mismatches with third countries that apply to all taxpayers subject to corporate tax in one or more Member States, including permanent establishments in one or more Member States of entities resident for tax purposes in a third country. Rules on reverse hybrid mismatches also apply to entities treated as transparent for tax purposes by a Member State.

Furthermore, ATAD II extends the hybrid mismatch definition of ATAD I which covers situations of double deduction or deduction without inclusion resulting from hybrid entities or hybrid financial instruments to include mismatches resulting from arrangements involving permanent establishments, hybrid transfers, imported mismatches and reverse hybrid entities. ATAD II also includes rules on tax residency mismatches. Mismatches that pertain to hybrid entities are only covered where one of the associated enterprises has effective control over the other associated enterprises. Deduction without inclusion arising due to the tax (exempt) status of a payee or the fact that an instrument is held subject to the terms of a special regime is not to be treated as a hybrid mismatch.

To the extent that a hybrid mismatch results in double deduction, the deduction shall be denied in the investor Member State or, as a secondary rule, in the payer Member State. Nevertheless, any deduction shall be eligible for off-setting against dual inclusion income now or in the future. To the extent that a hybrid mismatch results in a deduction without inclusion, the deduction shall be denied in the payer Member State or, as a secondary rule, the amount of the payment shall be included as taxable income in the payee Member State.

Insofar as ATAD II covers imported mismatches which arise where an entity (the payee) sets off a hybrid mismatch payment against an otherwise taxable receipt arising on a payment from the payer, the payer is denied all or part of the deduction for the payment. The taxpayer Member State shall deny a deduction to the extent a hybrid mismatch is imported.

To the extent a hybrid mismatch involves disregarded permanent establishment income, the Member State in which the taxpayer is tax resident shall require income inclusion unless a double tax treaty concluded with a third country requires exemption of the income.

As noted above, hybrid transfers, reverse hybrids and tax residency mismatches also fall within the scope of ATAD II. To the extent a hybrid transfer is designed to produce withholding tax relief to more than one of the parties involved, the taxpayer Member State shall limit the relief in proportion to the net taxable income regarding the payment. A hybrid entity shall be regarded as a resident of the Member State of incorporation or establishment and taxed on its income to the extent this income is not otherwise taxed. This rule shall not apply to collective investment vehicles. Finally, to the extent dual (or more) tax residency results in double deduction, the taxpayer Member State shall deny deduction insofar as the duplicate deduction is set-off in the other jurisdiction against non-dual-inclusion income. If both jurisdictions are Member States, the loser State under the residency tie-breaker rule of the relevant double tax treaty shall deny the deduction. Member States may under certain conditions, and temporarily, exclude hybrid mismatches resulting from intra-group instruments issued with the sole purpose of meeting the issuer's loss-absorbing capacity requirements (e.g. regulatory hybrid capital).

Next steps

Member States will need to transpose the provisions of ATAD II by 31 December 2019 and apply them per 1 January 2020. This applies to both mismatches between Member States and between Member States and third countries. By way of derogation, the reverse hybrid entity rule (requiring taxation of income to the extent not otherwise taxed) will need to be transposed by 31 December 2021 and applied per 1 January 2022. Payments to reverse hybrids will however not be deductible anymore from 1 January 2020.

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EU – European Commission proposes mandatory disclosure rules for intermediaries

On 21 June 2017, the European Commission adopted a proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, in relation to reportable cross-border arrangements. The stated objective of this proposal, which provides for mandatory disclosure of cross-border arrangements by intermediaries or taxpayers to the tax authorities and mandates automatic exchange of this information among Member States, is to enhance transparency, reduce uncertainty over beneficial ownership and dissuade intermediaries from designing, marketing and implementing harmful tax structures.

The proposed measure applies to a cross-border arrangement which is defined as an arrangement or series of arrangements in either more than one Member State or a Member State and a third country. A cross-border arrangement also covers dual resident taxpayers and taxpayers carrying out a business through a permanent establishment (PE) in another jurisdiction insofar as the cross-border arrangement forms part or the whole of the business of that PE. Alternatively, the proposed measure may also apply to cross-border arrangements with a tax related impact in at least two jurisdictions.

For such arrangements to require being reported to the tax authorities, at least one of the hallmarks must be met. These hallmarks may be generic or specific. Generic hallmarks include, for example, an arrangement or series thereof whereby the taxpayer is under the obligation to not disclose how such arrangement can secure a tax advantage *vis-à-vis* other intermediaries or the tax authorities or when the intermediary receives a fee for its services proportionate to the amount of the tax advantage. Specific hallmarks include (but are not limited to) the use of losses to reduce tax liability, conversion of income into lower-taxed revenue streams and circular transactions. These kind of general and specific hallmarks will serve as indicators rendering a cross-border arrangement reportable insofar as they meet the main benefits test, which states that the main benefit for setting up a structure is to obtain a tax advantage. Additionally, specific hallmarks related to cross-border transactions, transfer pricing and automatic exchange of information, which do not need to comply with the main benefits test, are included in the proposal.

The intermediary is under the obligation to disclose information with the competent authorities on a reportable cross-border arrangement within five working days beginning on the day when the arrangement is made available for implementation to the taxpayer or where the first step of such arrangement has already been implemented. Insofar as the intermediary is entitled to a legal profession privilege under national law, the disclosure obligation shifts to the taxpayer. Equally, insofar as there is no intermediary (e.g. because the taxpayer implements a scheme in-house or the intermediary does not have presence within the EU), it is the taxpayer's responsibility to disclose such information within five working days beginning on the day after the arrangement or the first step thereof has been implemented.

Insofar as the intermediary files information on a reportable cross-border arrangement or series of arrangements, the Member State in which the information was filed will, by means of an automatic exchange, communicate that information to all other Member States.

Member States will need to take the necessary measures to require intermediaries and taxpayers to file information on reportable cross-border transactions that will have been implemented between the date of the formal adoption of the proposal by the Council and 31 December 2018, which information needs to be disclosed by 31 March 2019. The provisions of the proposed measure are then set to apply as per 1 January 2019 with exchange on a quarterly basis within one month of the end of the quarter (the reference to the first information being disclosed by 31 March 2019 is thought to apply to the retrospective element as discussed above). The Commission's proposal will now be sent to the Council and the European Parliament. The Directive needs to be formally adopted by the Council by unanimous vote, after consultation of the European Parliament.

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EU – ECOFIN Council of 23 May 2017: agreement on Double taxation dispute resolution mechanism in the EU

On 23 May 2017, the Council agreed on a new system for resolving double taxation disputes within the EU. The proposal sets out to improve the mechanisms used for resolving disputes between Member States when disputes arise from the interpretation of agreements on the elimination of double taxation. The draft Directive builds on the EU Arbitration Convention 90/436/EEC on the elimination of double taxation in connection with the adjustments of profits of associated enterprises.

The draft Directive requires dispute resolution mechanisms to be mandatory and binding, with clear time limits and an obligation to reach results and a stated aim is to reduce compliance costs for businesses to a minimum.

Member States will have until 30 June 2019 to transpose the Directive into national laws and regulations. It will apply to complaints submitted after that date on questions relating to a tax year starting on or after 1 January 2018. Member States may however agree to apply the Directive to complaints submitted prior to that date or related to earlier tax years.

The Council endorsed a compromise reached on the following issues:

- A broad scope but with the possibility, on a case-by-case basis, of excluding disputes that do not involve double taxation;

- Criteria to ensure the independence of those appointed to a pool of independent arbitrators, who cannot be employees of tax advice companies or have given tax advice on a professional basis. Unless agreed otherwise, the panel chair must be a judge;
- A permanent structure or standing committee may be set up to deal with dispute resolution cases if Member States can agree to that.

The Council will adopt the Directive following the European Parliament having given its opinion (on 5 July 2017). It is expected that this Directive will be formally adopted at a Council meeting in July (not necessarily the ECOFIN Council).
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EU – ECOFIN Council of 16 June 2017: Main results

The ECOFIN Council endorsed the Maltese EU Council Presidency's six-monthly progress report to the European Council on tax issues.

With regard to the Code of Conduct (Business Taxation), the ECOFIN Council stated it:

- Welcomes the progress achieved by the Code of Conduct Group during the Maltese Presidency as set out in its report;
- Asks the Group to continue monitoring standstill and the implementation of the rollback and invites the Group to continue its work under the Work Package 2015;
- Takes note of the progress made on the alignment of the patent box regimes with the agreed nexus approach and invites the Group to continue to monitor and report on this process;
- Asks Member States whose patent box regimes do not comply with the modified nexus approach to align these regimes as soon as possible;
- Invites the Code of Conduct Group to continue to work on the application of the principles of the modified nexus approach to non-IP regimes, taking into account relevant international developments on this matter;
- Takes note of the progress achieved by the Code of Conduct Group in its ongoing work in the context of Council conclusions of 8 November 2016 on the criteria and process leading to the establishment of the EU list of non-cooperative jurisdictions for tax purposes, and asks the Code of Conduct Group to continue this work;
- Reiterates that the Code Group should continue exploring defensive measures that could be taken, and notes that if certain legislative files under negotiation (without prejudice to the outcome thereof) contain a link to the future list of non-cooperative jurisdictions, such provisions could also constitute a set of effective and dissuasive defensive measures at EU level in non-tax area; subject both to the agreement on the list and the objective and aim of the relevant legislative files;
- Endorses the 'Guidance Note on tax privileges related to special economic zones' annexed to the report by the Code of Conduct Group;

- Asks the Code of Conduct Group to continue its work on a draft guidance note on the interpretation of the fourth criterion;
- Invites the Commission to continue the dialogue with Liechtenstein on the application of the principles of the Code of Conduct, as set out in the report (...)"

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

EU – European Parliament PANA Committee issues draft report and draft recommendations

On 30 June 2017 the draft inquiry report and the draft recommendations of the PANA Committee were published for consideration by the full PANA Committee on 10 July 2017. The draft inquiry report presents the PANA Committee's findings on discrepancies between the “practices revealed in the Panama Papers and EU law, notably the EU Directives on Anti-money Laundering (AMLD) and on Administrative Cooperation in the field of Taxation (DAC)”. PANA’s draft recommendations (formally non-binding but politically significant) to the Council and the European Commission offer suggestions to improve the EU’s framework in particular in connection with the two abovementioned EU Directives. Both reports will be open for amendments in the PANA Committee until 5 September 2017 at 12:00.
-- Bob van der Made, PwC Netherlands-Brussels; bob.vandermade@pwc.com

EU – Public CBCR: European Parliament ECON and JURI Committees adopt joint report

On Monday 12 June, the EU Parliament's ECON and JURI Committees adopted their joint report on the European Commission's draft public CBCR Directive, with 38 votes in favour, 9 against and no less than 36 abstentions. The co-rapporteurs Bayet (Belgium, S&D) and Regner (AU, S&D) on this dossier tabled the ECON-JURI report as a draft legislative Resolution with amendments on 21 June for a plenary vote and adoption in Strasbourg on 4 July 2017.

The plenary vote in the European Parliament on the draft resolution was held on 4 July. MEPs agreed on a compromise text and adopted the resolution.

The European Parliament’s resolution is not a legislative act but serves as MEPs’ common negotiating stance and mandate for subsequent Trilogue negotiations with representatives of the Council (Member States) and the Commission, which should start after the Summer break and which are aimed at reaching a final compromise text of the Directive.

A document on the State of Play in Council / Council Presidency compromise text prepared by the outgoing Maltese EU Presidency was issued on 22 June 2017 and is publically available.
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Italy – EU Tax Commissioner Moscovici concludes that Italian flat tax for high net worth individuals does not appear to constitute harmful tax competition

On 15 June 2017, EU Commissioner for Economic and Financial Affairs, Taxation and Customs Moscovici replied in writing to written questions by Members of the European Parliament inquiring whether the recently introduced flat tax for high net worth individuals by Italy gives rise to harmful tax competition.

The regime provides for an annual lump-sum substitute tax of EUR 100,000 on foreign-source income available to individuals who have acquired an Italian tax residence from 2017 onwards. This is applicable only insofar as these individuals were not resident in Italy in the previous 9 out of 10 years. The regime of the substitute tax is effective up to a maximum period of 15 years and may also be extended to close family members (against the payment of an additional annual lump-sum substitute tax of EUR 25,000 per family member).

The Commissioner concluded that the new regime does not constitute harmful tax competition, releasing the following statement:

"*Harmful tax measures in the EU are dealt with under the rules of the Code of Conduct for Business Taxation (Code). The Code covers business taxation measures which affect the location of business activity in the EU. The national measure referred to appears to concern taxation of individuals which is prima facie not covered by the scope of the Code. However, a possible inclusion of such measures in the scope of the Code has been discussed in a Council Working Party in line with the Economic and Financial Affairs Council conclusions of 7 December 2010 (Document 17380/10 FISC 149). The working party took the view that personal income taxation, as a general rule, falls outside the scope of the Code but that certain aspects of such taxation may be taken into account if their interaction with other tax measures creates harmful results for business taxation. The national regime referred to in the question does not appear to produce such results and it would therefore not be within the scope of the Code. The Commission has proposed reforms of the Code in order to modernise it and make it more effective with some useful results so far. However, so far there has been no consensus on widening the scope of the Code beyond the area of business taxation. Taking into account the substantial progress achieved in the last few years on the basis of Commission initiatives in terms of exchange of tax information, there is no apparent risk of tax avoidance due to the measure concerned. Furthermore, taking into account that Member States are free to decide national tax rates, there is no deviation from the principle of sincere cooperation*".

-- Claudio Valz, Luca la Pietra and Guglielmo Ginevra, PwC Italy; claudio.valz@it.pwc.com

Spain – European Commission starts infringement procedure on state liability for breach of EU law

On 15 June 2017, the European Commission, after having received several complaints, formally notified Spain that its national rules on state liability for a breach of EU law do not comply with the principles of equivalence and effectiveness.

The Spanish law on state liability arising from a contravention of EU law was amended by Law 40/2015, which entered into force in October 2016. The amended law limits the reimbursement of damages to a time period of five years prior to the publication of the CJEU judgment declaring an infringement of EU law. Additionally, the new provisions require the claimant to have previously appealed against the application of the Spanish law that is in breach of EU law and to have demonstrated the existence of such infringement before the national bodies. Moreover, less favourable conditions apply to liability for a breach of EU law in comparison to liability arising from a breach of the Spanish Constitution insofar as it is required to attest that the requirements established by the CJEU's prevailing case law are fulfilled. Among other things, the claimant must prove that the infringement can be qualified as sufficiently serious, which is not required for a constitutional breach. In the view of the Commission, the contested national provisions thus render state liability for a breach of EU law excessively difficult and have a negative impact on the effectiveness of EU law.

This is the first step of the infringement procedure. Spain has a two-month period to file a detailed reply pursuant to which if the Commission may send a reasoned opinion (i.e. a formal request to comply with EU law) if it concludes that Spain has failed to fulfil its obligations under EU law. In that case, if the new regime is not amended, the Commission may decide to refer the matter to the CJEU.

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Fiscal State aid

EU – European Commission and China start dialogue on State aid control

On 2 June 2017, EU Competition Policy Commissioner Vestager and the Chairman of China's National Development and Reform Commission, He Lifeng, formally signed a Memorandum of Understanding in Brussels to start a dialogue on State aid control. The dialogue will be used to share with China the European experience in enforcing State aid control. It will also be used to learn more about the implementation of the newly adopted Fair Competition Review in China, which is designed to prevent public policies from distorting and restricting competition while maintaining fair market competition and promoting a unified market. The dialogue will be supported by cooperation with working groups at technical level and is due to take place at least once a year, alternating between Brussels and Beijing.

According to the Commission's press release: "This new State aid cooperation dialogue is part of the Commission's broader strategy to address the distortion that national subsidies policies put on the promotion of a global level playing field where companies can compete on their merits. (…) At bilateral level, the Commission has engaged in a wide range of cooperation activities with competition authorities of a number of non-EU countries on the basis of agreements or memoranda of understanding."
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EU – European Commission adopts annual Competition Policy Report for 2016

On 31 May 2017, the European Commission adopted its Report on Competition Policy 2016. The report, published annually, provides detailed information on the most important policy and legislative initiatives, and on decisions adopted by the European Commission in application of EU competition law during the previous year. The report is composed of two documents: a Communication from the Commission and a Commission (Staff Working Document) describing the developments in more detail.
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Hungary – Advertisement Tax Act aligned to comply with the State aid rules

As per 1 July 2017, the Hungarian Advertisement Tax Act has been amended to align it with the negative State aid decision (SA.39235) issued by the European Commission on 4 November 2016.

The Advertisement Tax was introduced in 2014 with highly progressive tax rates ranging from 0% and 1% (for companies with small or medium-sized advertising turnover) to 50% (for companies with high advertising turnover). After the European Commission opened an in-depth State aid investigation in March 2015 arguing that the steeply progressive rates could favour smaller companies and also that the utilisation of corporate tax losses granted a selective advantage to companies that were loss-making in 2013, the Hungarian Parliament amended the Advertisement Tax Act in July of 2015 and replaced the progressive rates with a 5.3% fixed measure while the tax base up to HUF 100 million (approximately EUR 330,000) was still taxed at 0%. However, the Commission concluded that there was still no objective justification for the differential treatment (i.e. the tax rate of 0% vs. 5.3%) and voiced its concern over the progressivity of the Hungarian rates. Moreover, the limitations on deductions of past losses remained unchanged. As a consequence, Hungary was obliged to remove the unjustified discrimination of companies under the Advertisement Tax Act and recover the granted State aid from the beneficiaries.

Although the Hungarian Government continues to disagree with the Commission's decision and has meanwhile initiated a CJEU action for annulment (C-204/17 P/R), the Hungarian Parliament amended the Advertisement Tax Act in order to comply with the Commission's decision.

As a result, as per 1 July 2017, the tax base – notably, the net advertising turnover – is subjected to a tax rate of 7.5%, while tax bases up to HUF 100 million are exempted from taxation. Since the Commission's decision concluded that the application of a 0% tax rate granted selective State aid to companies with low advertising turnover, the latest amendments prescribe that this exemption qualifies as *de minimis* aid as defined by Articles 107 and 108 TFEU. In addition, the amendment also stipulates that the tax rate for the period between 1 January 2017 and 30 June 2017 is 0%, while any tax declared and paid with respect to previous periods (i.e. from 2014 to 30 June 2017) qualifies as tax overpayments and refunds may be claimed accordingly based on the individual notifications received from the Hungarian Tax Authority. Even though Hungary has amended its law in order to comply with its EU obligations, due to its appeal against the decision, the final word rests with the CJEU.

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Spain – CJEU judgment on tax exemptions for Catholic Church

On 27 June 2017, the CJEU rendered its judgment in *Congregación de Escuelas Pías Provincia Betania* (C-74/16) concluding that the tax exemption for the Catholic Church in Spain in respect of construction works on a school may constitute unlawful State aid insofar as this exemption is granted for economic activities.

The tax exemption for the Catholic Church and its related bodies (such as congregations) follows from the International Convention between Spain and the Vatican concluded in 1979 prior to Spain's accession to the EU. In this case, a Catholic congregation in charge of a private school, which receives public subsidies for public educational purposes, claimed a refund of the Spanish municipal tax on constructions, installations and works. The city council of Getafe rejected the refund application and the congregation brought an appeal before a domestic court which subsequently referred the case to the CJEU requesting a preliminary ruling in order to determine whether the exemption from certain taxes granted by a Member State to a religious community may constitute unlawful State aid on the grounds of Article 107 TFEU.

In line with the opinion rendered by AG Kokott, the CJEU concluded that tax exemptions for Catholic Church-run schools do not, as a general rule, contravene the prohibition arising from the State aid rules. Nevertheless, the tax exemption may constitute unlawful State aid if the activities carried out by the congregation are economic activities, a matter which is for the Spanish court to determine. In this regard, the CJEU distinguishes between on one hand compulsory and public education activities (which are subsidised by Spain with public funds) and pure religious related activities and on the other hand, other educational activities (which are not subsidised by Spain) and which are a purely private nature. According to the CJEU, as to the first type of activities, it may be assumed that such activities have a non-economic character rendering the State aid prohibition non-applicable. As to the second type of activities, in the view of the CJEU these appear to be of an economic nature and are therefore within the scope of the State aid provisions. Regarding these latter activities, the CJEU concluded that the tax exemption satisfies the conditions for classification as unlawful State aid but it also stated that any aid not exceeding a ceiling of EUR 200,000 over a period of three years is deemed not to affect trade between Member States (*de minimis* rule). The national court will thus have to determine whether that threshold is reached taking into account only the advantages that the congregation has obtained in respect of economic activities.

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United Kingdom – CJEU judgment on the Gibraltar Betting and Gaming Association

On 13 June 2017, the CJEU rendered its judgment in the *Gibraltar Betting and Gaming Association* (GBGA) (C-591/15) ruling against GBGA's appeal for its members to be exempt from the UK's 15% remote gaming consumption tax. This judgment clarifies the legal relationship between the UK, Gibraltar and the EU.

The tax was introduced in 2014 and is paid by UK residents who engage in online gambling with non-UK companies. Companies levy and remit the tax to HMRC. The GBGA argued that the 15% consumption tax, along with Gibraltar's own 1% online gaming duty, creates double taxation.

The CJEU considered whether, for the purposes of Article 56 TFEU, Gibraltar and the UK are to be treated as effectively a single Member State or whether, with respect to the freedom to provide services, Gibraltar has, as a matter of EU law, the constitutional status of a separate territory to the UK such that the provision of services between the two constitutes cross-border intra-EU trade. In determining this question, the CJEU had regard in particular to Article 355(3) TFEU, which provides that the EU Treaties are to apply to the European territories for whose external relations a Member State is responsible. This applied to Gibraltar. Though the CJEU confirmed that Gibraltar does not form part of the UK and is a European territory, it agreed with the AG's opinion that the UK and Gibraltar are effectively a single Member State for the purposes of the four fundamental freedoms, despite the number of exemptions and special rules negotiated for Gibraltar when the UK joined the EU. It follows from this that the provision of services by operators established in Gibraltar to persons established in the UK is a situation which for EU law purposes is purely domestic. As a result, the CJEU ruled that in this context, the GBGA could neither invoke nor rely upon the freedom to provide services.

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About the EUDTG

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 or EEA presence understand the impact as they explore their activities, opportunities and investment decisions.

So how do we help you?

- Our experts combine their skills in EU law with specific industry knowledge by working closely with colleagues in the Financial Services and Real Estate sectors.
- We have set up client-facing expert working groups to address specific key topics such as EU State aid & BEPS and CCCTB.
- Through our Technical Committee we constantly develop new and innovative EU law positions and solutions for practical application by clients.
- We closely monitor direct tax policy-making and political developments on the ground in Brussels.
- We input to the EU and international tax debate and maintain regular contact with key EU and OECD policy-makers through our EU Public Affairs capability.
- Our secretariat in the Netherlands operates an EU tax news service, keeping clients up to date with developments as soon as they happen.

And what specific experience can we offer for instance?

- Our PwC State Aid Working Group helps clients identify and manage EU State Aid risks.
- Together with our Financial Services colleagues, we have assisted foreign pension funds, insurance companies and investment funds with dividend withholding tax refund claims.
- We have assisted clients before the CJEU and the EFTA Court in landmark cases e.g. *Marks & Spencer* (C-446/03), *Aberdeen* (C-303/07), *X Holding BV* (C-337/08), *Gielen* (C-440/08), *X NV* (C-498/10), *A Oy* (C-123/11), *Arcade Drilling* (E-15/11), *SCA* (C-39/13), *X* (C-87/13) *and Kieback* (C-9/14).
- We have carried out a number of tax studies for the European Commission.

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