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EU Tax News

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CJEU Cases

Netherlands – CJEU judgment on pro-rata personal deductions for non-resident taxpayers: *X*

On 9 February 2017, the CJEU rendered its judgment in a case referred to it by the Dutch Supreme Court regarding the deduction of expenses relating to a dwelling (negative income) situated in the Member State of the taxpayer's residence, by the Member States where the taxpayer exercised professional activities (Member States of activity). The CJEU accepted a right of mortgage interest deduction in the Member State of activity in proportion to the share of income received in that Member State (*X*, C-283/15).

In 2007, X, a Dutch national and tax resident in Spain at that time, received income from his professional activity consisting of payments made by two companies in which he held majority shareholdings, one of which was established in the Netherlands, the other in Switzerland. The income from the Dutch source represented 60% of his total taxable income, while the income from the Swiss source represented 40% of that total. No positive income was generated in Spain, either in 2007 or in the four following years, after which X ceased to be Spanish tax resident.

Under the applicable bilateral tax treaty, the income from the Swiss source was taxed in Switzerland and the income from the Dutch source in the Netherlands. However, the Dutch tax authorities did not permit the deduction of the negative income in the Netherlands. X claimed that the Netherlands should permit such a deduction without being compelled to elect to be treated in the same way as resident taxpayers.

The Supreme Court of the Netherlands was doubtful as to the application of the CJEU judgment in *Schumacker* (C-279/93) in this case; contrary to the facts of Schumacker, X did not receive all or almost all his family income in a single Member State, other than that of his residence, which had the power to tax that income and which could, therefore, take account of his personal and family circumstances (if enough income would have been generated there).

The CJEU ruled as follows:

1. Since the non-resident taxpayer could not claim deductions for personal and family circumstances in his Member State of residence (i.e. Spain), because he was not receiving income there, the Member State of activity must permit a proportionate deduction of the negative income relating to a dwelling in the Member State of residence.
2. The non-resident taxpayer may claim a deduction in proportion to the share of income received in each Member State of activity (in this case 60% in the Netherlands). In that regard, a Member State of activity is any Member State that has the power to tax income from the activities of a non-resident taxpayer as is

received within its territory, irrespective of where the activities are actually performed.

3. The fact that the non-resident taxpayer received part of his taxable income in a non-Member State (i.e. Switzerland) was of no relevance.

The CJEU did not rule on the relevance of the possibility to offset the negative income in subsequent tax years in the Member State of residence, as it considered the relevant question hypothetical and therefore inadmissible.

Based on this CJEU judgment it is also possible to claim deductions in different Member States of activity (working Member States) in view of personal and family circumstances. The CJEU judgment confirms that it is not necessary for the taxpayer to earn all or almost all of the family income in a single Member State of activity; decisive is whether the Member State of residence cannot take into account his personal and family situation due to the fact that the taxpayer earns his taxable income abroad. If so, the Member States of activity should take into account the personal and family situation of the taxpayer (proportionally). We expect that the Netherlands will amend the relevant tax legislation (Article 7.8 Personal Income Tax Act) on short notice. Furthermore, based on this CJEU judgment it is possible to claim a deduction for personal income tax returns for prior years, as long as the relevant tax assessments have not been finalised yet.

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Netherlands – CJEU judgment on the application of Article 64 (1) TFEU concerning the extended recovery period for foreign assets: *X*

On 15 February 2017, the CJEU rendered its judgment in *X* (C-317/15) regarding the extended recovery period for tax claims related to foreign assets under the Dutch tax legislation. The case concerned a taxpayer who held accounts in two banking institutions, one each in Switzerland and Luxembourg, neither of which were included in his tax declarations.

Under the applicable Dutch legislation, there is a five-year period for the recovery of unpaid taxes. However, that period may be extended to twelve years with respect to foreign assets (Article 16 of the Algemene Wet inzake Rijksbelastingen). The extended recovery period for foreign assets has already been dealt with in *X and Passenheim-van Schoot* (C-155/08 and C-157/08). In the latter judgment, the CJEU ruled that legislation of a Member State providing for longer recovery periods in respect of taxable items "hidden" in another Member State is compatible with the free movement of capital and the freedom to provide services where the first Member State has no information about such items, but only if it applies proportionately.

Based on this provision, the Dutch tax inspector issued additional assessments for recovery in relation to income tax and social insurance contributions with respect to the accounts in Switzerland and Luxembourg. In domestic juridical proceedings, the taxpayer challenged the contention that Article 64(1) TFEU implied that the free movement of capital was not applicable for the recovery relating to his Swiss bank account. Article 64 (1) TFEU contains a derogation from the application of the provision on the free movement of capital (Article 63 TFEU) thus allowing the Member States to uphold any restrictions which existed on 31 December 1993 under national law adopted in respect of the movement of capital involving direct investment, establishment, the provision of financial services or the admission of securities to capital markets. When the case was brought before the Dutch Supreme Court, the Court expressed doubts regarding the scope of application of Article 64(1) TFEU in this case.

The CJEU ruled that the application of Article 64(1) TFEU depends on the effect of the national legislation and not on its purpose. In this respect, Article 64(1) TFEU applies to the national legislation introducing a restriction on the movement of capital, such as the extended recovery period, even where that restriction can also be applied to situations which have nothing to do with direct investment, establishment, the provision of financial services or the admission of securities to capital markets. Furthermore, the CJEU clarified that in order to be covered by the derogation provided for in Article 64(1) TFEU, the national measure must relate to capital movements that have a sufficiently close link with the provision of financial services, which requires that there be a causal link between the movement of capital and the provision of financial services. Finally, the CJEU ruled – reaffirming its earlier *Wagner-Raith* (C-560/13) judgment – that the fact that a national measure concerns first and foremost the investor and not the provider of a financial service cannot preclude that measure from coming within the scope of Article 64 (1) TFEU.

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National Developments

Belgium – New Innovation Income Deduction replaces the Patent Income Deduction

The Act of 9 February 2017 introduces the new Innovation Income Deduction (IID) regime, which replaces the Patent Income Deduction (PID). In contrast to the previous regime, the qualifying patent/innovation income is calculated on a net basis. The percentage of the new deduction will be raised from 80% under the PID regime to 85% under the new IID regime resulting in an effective tax rate of 5.1% over the lifetime of the intellectual property (IP).

The IID applies to income derived from the following IP of which the company or branch has the full ownership, co-ownership, usufruct, license or exclusive rights:

- patents and supplementary protection certificates;
- breeders' rights requested or acquired as from 1 July 2016;
- orphan drugs, i.e. a drug to treat rare diseases, (limited to first ten years) requested or acquired as from 1 July 2016;
- data and market exclusivity granted by the competent authorities (e.g. market exclusivity for orphan drugs or data exclusivity for reports with respect to pesticides, clinical studies of generic or animal drugs);
- IP of copyrighted software resulting from a research or development project as defined for the purposes of the partial exemption of wage withholding tax for research and development.

All marketing related intangibles such as trademarks still do not qualify for tax benefits under the IID regime.

Without creating any restrictions for small and medium-sized enterprises (SMEs), the following income will be considered as derived from the above qualifying IP in so far as the remuneration is included in the Belgian taxable result of the Belgian company or branch concerned:

- license fees;
- IP income embedded in the sales price of own manufactured products for which a third party would be willing to pay a license (so-called 'embedded' royalties);
- IP income derived from process innovation; and
- damages on the basis of a court decision, an amicable settlement or an insurance settlement.

Furthermore, capital gains on qualifying IP will also be included in the scope of the deduction going forward subject to a reinvestment condition to be met within five years.

Taking into account the modified nexus approach, the IID will be determined by multiplying the innovation income with the below ratio. The fraction represents the ratio between the own R&D activities and the outsourced R&D activities/acquired IP (towards/from related parties). As such, the taxable result of a Belgian company or branch will be reduced by 85% of the total net innovation income after this fraction has been applied. It is important to note that going forward, the ratio will be calculated on a net basis implying that (contrary to the PID regime) current-year deducted overall expenditure should be deducted from the current-year qualifying innovation income. It is thereby also provided that any excess deduction that cannot be used due to insufficient taxable basis can be carried forward to be compensated with future taxable profits (contrary to the previous PID regime). Furthermore, the IID Act provides for continuity of the IID in the case of tax neutral reorganisations (e.g. contribution, merger or (partial) demerger).

The qualifying expenditure is the expenditure incurred by the company itself or the compensation for expenses of non-related companies in relation to outsourced R&D activities. Qualifying expenditure must be directly connected to the qualifying IP. The expenditure does not include interest payments, costs related to immovable assets or any costs that could not be directly linked to a specific intangible.

The qualifying expenditure may be uplifted by 30% with a maximum of the overall expenditure. The overall expenditure in the denominator of the ratio includes the qualifying expenditure increased with the acquisition costs related to qualifying intangible property and the expenditure for related-party outsourcing.

The new regime has entered into force as per the assessment year 2016, meaning it would apply to financial years ending on or after 1 July 2016. No new entrants can benefit from the previous PID regime from 1 July 2016. Taxpayers benefitting from the previous PID regime will be able to choose the PID or the new IID regime and, if they choose the PID, they will be able to receive these benefits for five years (grandfathering until 30 June 2021). The choice for the new IID regime is irrevocable.

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Finland – Supreme Administrative Court confirms withholding tax treatment for non-UCITS and non-listed Maltese SICAV

As noted in PwC EUDTG Newsletter Issue 2015 – nr. 004, the Finnish Central Tax Board (CTB) published in May 2015 a decision (CTB 13/2015, dated 30 April 2015) on an advance ruling request concerning the taxation of dividends received by a Maltese SICAV from Finnish listed companies. The Maltese SICAV in question was both non-listed and non-UCITS.

In its decision, the CTB discussed the characteristics of the SICAV in question and considered it to be mainly comparable to a Finnish limited liability company with investment activities. Accordingly, and as the Maltese SICAV in question did not hold at least 10% of the capital of the listed companies distributing the dividends (which is a condition for the tax exemption in a comparable purely domestic situation where a listed company distributes dividends to a non-listed company), the withholding tax levied on the Maltese SICAV was not contrary to Article 63 TFEU. As noted above, the SICAV was considered mainly comparable to a Finnish limited liability company even though the CTB also discussed the SICAV's characteristics and the comparability to a Finnish investment fund (which is tax exempt).

With its (unpublished) decision dated 19 December 2016, the Supreme Administrative Court (SAC) upheld the CTB's decision by rejecting the SICAV's appeal. In its decision, the SAC notes, as a starting point, that the Maltese non-listed and non-UCITS SICAV in question is not fully comparable to any Finnish type of entity. Ultimately, the SAC agreed with the CTB's analysis and considered the SICAV mainly comparable to a Finnish non-listed limited liability company. As a result of this classification and comparability to a non-listed Finnish limited liability company, the SICAV's withholding tax treatment (i.e. the levying of withholding tax on the dividends received from Finnish publicly listed companies) is not contrary to EU law as the dividends received by a non-listed Finnish limited liability company from a Finnish publicly listed company would also be taxable.

While the SAC's decision concerns directly only the Maltese SICAV in question, it remains to be seen whether the negative effects of the decision will be limited only to non-UCITS SICAVs.

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Hungary – Hungarian implementation of ATAD's CFC rules

As per 18 January 2017, the Hungarian Controlled Foreign Corporation (CFC) regime has been significantly amended. The amendment is said to be the (partial) implementation of the CFC rules as set forth in the Council Directive (EU) 2016/1164 (ATAD).

Under the old Hungarian CFC regime, the CFC rules captured those foreign persons i) whose income was sourced in Hungary or who had a Hungarian private individual beneficial owner (of at least 10%), and ii) whose effective tax rate (or the applicable headline rate in the case of losses) did not amount to 10%. Certain carve-out rules (such as real economic presence within the EU, the OECD, or double tax treaty party states, or listing on a recognised stock exchange) were available. The unexpected amendment of the Hungarian CFC rules – preceding by two years ATAD's statutory implementation deadline – combines the wording of the ATAD's CFC and the old CFC rule.

Per the new legislation, a Hungarian domestic taxpayer shall treat a foreign entity or a foreign permanent establishment (PE) as a CFC if the following conditions are cumulatively met:

- in the case of a foreign entity, the taxpayer by itself or together with its associated enterprises holds a direct or indirect participation of more than 50% in the registered capital, voting rights or rights to the profits; and
- the actual corporate tax paid on its profits by the foreign entity or PE is lower than half of the corporate tax that would have been levied on the entity or PE under the applicable corporate tax rules in Hungary.

However, the CFC rules do not apply if:

- it can be established that the foreign entity or PE carries on a substantive economic activity supported by appropriate staff, equipment, assets and premises (as evidenced by the relevant facts and circumstances); or
- on each day of the business year, there is at least a 25% shareholder in the foreign entity whose shares or whose related party's shares have been listed on a recognized stock exchange for at least five years on the first day of the business year (this exemption does not apply to foreign PEs).

Should the CFC status be established, the Hungarian taxpayer must include in its tax base 100% of certain passive income streams (e.g. interests, royalties, income derived from the holding, alienation of shares, etc.) of the foreign entity or PE, irrespective of its actual participation in the CFC.

However, the interpretation of the new CFC regulation is uncertain, due to the fact that:

- its adoption precedes by two years implementation of ATAD's CFC rules, which themselves may raise uncertainties (e.g. the question of the precedence of double tax treaties over EU Directives or the possible double taxation that may arise from both directly and indirectly held participations giving rise to a possible CFC qualification); and
- the new Hungarian rules cannot be viewed as the precise implementation of the ATAD's CFC rules (e.g. both directly and indirectly held participations may trigger the Hungarian taxation of the CFC's total passive income, not just that of the proportionate amount).

As a result, a subsequent amendment of the new CFC regime is expected (without altering the underlying basic concept). Nonetheless, a careful review of existing structures is recommended provided that the CFC status has to be considered on entirely different grounds than was the case under the previous regime, thus potentially giving rise to implications for many entities (i.e. holding companies, PEs).

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Italy – Italian Tax Court of First Instance judgment on the compatibility of withholding tax levied on dividends distributed to a US pension fund with EU law

On 6 April 2016, the Pescara Tax Court of First Instance (decision n. 291-1-2016) ruled that a US pension fund (the claimant) is comparable to an Italian pension fund and thus, it cannot be subject to a different withholding tax on its portfolio dividends received from Italian companies. The comparison took place based on the US pension fund's main features.

In 2008, the claimant received dividends from several Italian companies. Upon the distribution of those dividends, the fund was subject to a 15% dividend withholding tax (in accordance with Article 10 of the USA-IT double tax treaty) whereas an Italian pension fund in a comparable situation would have been subject to a 11% substitute tax on its global annual result (thus, not on the dividends received).

The court considered that such differential tax treatment of the dividends received constitutes an infringement of the free movement of capital (Article 63 and 65 TFEU). The judges highlighted that this freedom also applies with respect to a Member State and a third country even if these two states have signed a double tax treaty.

The Italian court affirmed that such discrimination cannot be justified by the fact that US pension funds were not subject to tax in the previous fiscal years nor by the fact that the double tax treaty prevailed over EU law in tax matters. According to the court, the non-taxation of the fund in the previous fiscal years is irrelevant. What is relevant is that the fund was subject to a higher tax burden due to its residence in the year for which it requested the (partial) refund of the Italian withholding tax.

Therefore, the Italian court concluded that the US pension fund was entitled to a refund of the higher tax paid in Italy.

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Sweden – Swedish Supreme Administrative Court judgments on the denial of refund of Swedish withholding tax

On 22 February 2017, the Swedish Supreme Administrative Court (SAC) ruled in two separate judgments (Case 2847-12 and Case 2868-12) that two foreign pension funds were not entitled to a refund of Swedish withholding tax. The SAC's judgments were based on the CJEU's judgment in *PMT* (C-252/14), one of the cases for which the SAC had requested a preliminary ruling from the CJEU.

In case 2868-12 a Dutch pension fund (represented by PwC Sweden) argued that the Swedish yield taxation of Swedish pension trusts and life insurance companies is more favourable compared to the withholding tax applied to foreign pension funds and that this was a restriction on the free movement of capital (Article 63 and 65 TFEU). The SAC referred the case to the CJEU for a preliminary ruling, which ruled that the fund was not comparable to Swedish funds and life insurance companies since it was not subject to tax on all of its assets in Sweden. Based on the CJEU's judgment, the SAC concluded that the Dutch fund was not entitled to a refund of the withholding tax levied in Sweden.

The SAC reached a similar conclusion in case 2847-12 where a Finnish pension fund had also applied for a refund of Swedish withholding tax based on its comparison to Swedish national pensions funds (*AP* funds). The SAC stated that there were significant differences between the Finnish pension fund and AP funds since the latter operate under different conditions (both organisationally and in terms of their function and purpose) as compared to the former. Therefore, the Finnish pension fund was not considered comparable to Swedish pension funds.

It must be noted that in its preliminary judgment, the CJEU stated that expenses directly connected to the receipt of dividends should be deductible at the level of the foreign fund if the national legislation allows such deduction to domestic funds. In the SAC's interpretation, costs incurred in connection with the acquisition, financing or managing of shares cannot be considered to be directly connected to the received dividends. However, the SAC stated that it cannot be excluded that there may be costs that fulfil the direct connection requirement related to the received dividends in exceptional cases. The claims regarding the deduction of costs were remitted to the Swedish Tax Agency.

The SAC judgments close the door to foreign pension funds with respect to their refund requests concerning Swedish withholding tax unless they are government pension funds with very similar organisational structure, function and purpose as Swedish government pension funds. Furthermore, there should also be limited room for foreign funds to deduct costs related to Swedish withholding tax in Sweden.

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Switzerland – Corporate Tax Reform III rejected by the Swiss voters

With a majority of 59.1%, the Swiss voters rejected the Corporate Tax Reform III (CTR III) in a public vote held on 12 February 2017. The CTR III, initially triggered by the EU (challenging certain Swiss tax regimes), was the result of a long and complex political process. If adopted, the reform would have abolished several tax regimes, such as the rules for holding or mixed companies. The reform would have simultaneously introduced new internationally accepted measures such as the patent box, research and development (R&D) incentives, notional interest deduction and a basis step-up.

The need for reform is undisputed, even among CTR III opponents. The negative vote was rather due to disagreements on the type and scope of the proposed measures. A new proposal is expected to be developed as quickly as possible. The Swiss Federal Council has meanwhile already instructed the Federal Department of Finance to propose the basic parameters for a new reform project in the second quarter of 2017.

In terms of content, the new package is expected to bear many similarities to the rejected CTR III but it will also support and help maintain Switzerland's attractiveness as a business location by ensuring its compliance with internationally accepted standards. It is expected that the reform will not be ready to take effect in 2019 (as originally planned), but rather with a delay of one to two years.

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United Kingdom – Supreme Court judgment in R (on the application of Miller and another) v Secretary of State for Exiting the European Union

On 24 January 2017, the Supreme Court delivered its judgment on the Secretary of State's appeal against a decision that the UK Government could not give notice of the UK's withdrawal from the EU pursuant to Article 50(2) TEU without Parliamentary approval. It held that the UK Government did not have power under the Crown's prerogative to give notice pursuant to Article 50(2) TEU for the UK to withdraw from the EU. An Act of Parliament was required.

The core question was whether UK Government's ministers could give formal notice without a new Act of Parliament. Also raised in the case was the impact on the devolved administrations which led to the question, answered negatively, of whether consultation with or agreement of the devolved institutions would be necessary before notice to leave the EU could lawfully be given.

At the heart of the claimant's case was that legislation enacted by Parliament — the European Communities Act 1972 — conferred EU law rights on people in the UK, and that right granted in that way by Parliament could not be taken away by the Government. The claimant relied upon the long-established principle that Parliament's legal powers are constitutionally superior to the prerogative powers of the Government. The essence of the Government's case was that the conduct of foreign relations — including entry into and withdrawal from treaties — is a matter that falls within the prerogative. Withdrawal from the EU Treaties was, therefore, something that could be initiated by the UK Government using its prerogative authority.

The practical consequence of the judgment is that an Act of Parliament voted upon by Members of both the House of Commons and the House of Lords has been necessary in order to authorise the UK Government to give notice to withdraw from the European Union under Article 50(1) TEU. The judgment is predicated on the proposition that EU law is not a form of "foreign law" within the UK's constitutional order. Instead, it is a source of domestic UK law.

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EU Developments

EU – ECOFIN Council agreement on ATAD II

The EU-28 Finance Ministers in the ECOFIN Council reached agreement on a general approach to the Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (ATAD II) on 21 February 2017. After finalisation, ATAD II will be submitted for formal adoption at a forthcoming ECOFIN Council meeting after the European Parliament has formally issued its opinion on the European Commission) proposal, which is currently scheduled for 26 April 2017. Once formally adopted, Member States will need to transpose the provisions 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 specific reverse hybrid entity rule (requiring taxation of income to the extent not otherwise taxed) would need to be transposed by 31 December 2021 and applied per 1 January 2022, however payments to reverse hybrids would not be deductible anymore from 1 January 2020.

The Commission presented its proposal for ATAD II as part of the Corporate Tax Reform Package of 25 October 2016. This ATAD II proposal responded to a ECOFIN Council request made during the meeting of 12 July 2016, when Directive (EU) 2016/1164 on rules against tax avoidance (ATAD I) was adopted, to put forward a proposal on hybrid mismatches involving third countries in order to provide for rules consistent with and no less effective than the rules recommended by the OECD BEPS report on Action 2. Indeed, the terms and concepts contained in ATAD II are similar to those in the OECD's Action 2 report.

Key provisions of ATAD II

- 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 (PEs) in one or more Member States of entities resident for tax purposes in a third country. Rules on reverse hybrid mismatches also apply to all entities treated as transparent for tax purposes by a Member State.

- <u>(Hybrid) mismatch definition</u>: 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 PEs, hybrid transfers, imported mismatches, and reverse hybrid entities. In addition, ATAD II includes rules on tax residency mismatches. Mismatches covered are only those that arise between head office and PE, between PEs, between associated enterprises and those resulting from structured arrangements. 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.

- <u>Double deduction</u>: 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 set-off against dual inclusion income now or in the future.

- <u>Deduction without inclusion</u>: 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.

- <u>Imported mismatch</u>: the taxpayer Member State shall deny a deduction to the extent a hybrid mismatch is imported.

- <u>Disregarded PE income</u>: the Member State in which the taxpayer is tax resident shall require income inclusion to the extent a hybrid mismatch involves disregarded PE income not subject to tax in that Member State unless a double tax treaty concluded with a third country requires exemption of the income.

- Hybrid transfer: 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.

- Reverse hybrid: 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.

- Tax residency mismatches: to the extent dual (or more) tax residency results in double deduction, the taxpayer Member States 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 relevant double tax treaty shall deny the deduction.

- Options for exclusion: 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).

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EU – European Parliament Resolution of 14 February 2017 on the annual report on EU competition policy

On 14 February 2017, MEPs adopted an EU Parliament "own-initiative" resolution on the annual report on EU competition policy for 2017. The resolution reviews the European Commission's work on competition issues in the previous calendar year and makes recommendations as to which it should focus on.

Sections covered by the resolution:
- Integration of the single market
- The digital single market
- State aid
- Antitrust, cartel proceedings and merger control
- Sectoral aspects
- Towards more effective national competition authorities in the EU
- Democratic strengthening of competition policy
- International dimension of competition policy

See for the full European Parliament Resolution of 14 February 2017 on the annual report on EU competition policy.

Own-initiative reports are important political instruments for the European Parliament. Own-initiative reports can pave the way for new EU legislative proposals, and are considered important tools in the early phase of the EU legislative cycle. After the adoption of an EU Parliament resolution based on an own-initiative report, the

Commission is held to provide within 3three months, information to the EU Parliament in writing on action taken in response to specific requests addressed to it in the resolution, including in cases where it has not followed the EU Parliament's views.

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EU – Public CBCR: European Parliament's joint ECON & JURI Committee issues draft report

On 9 February 2017, the European Parliament's Economic and Monetary Affairs (ECON) Committee and the Legal Affairs Committee (JURI) published their joint draft report with recommendations on the European Commission's “proposal for a directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches” (aka pCBCR).

The European Parliament announced the joint committee referral to ECON & JURI on 19 January 2017. Prior to that date, only JURI was tasked to prepare this draft report.

The final vote on this draft report in the EU Parliament's joint ECON/JURI Committee is scheduled for 30 May 2017.

Meanwhile, at the Council, the Council’s Working Party on Company Law (Attachés CBCR) will reconvene on 29 March 2017 for a Malta EU Council Presidency “update on the Status of CBCR in the European Parliament”, discuss the “State of Play” on the pCBCR file in Council, and to further examine technical compromises on the text.

A representative of the Maltese EU Council Presidency apparently informed JURI MEPs on 13 January 2017 that the Council and the Maltese Presidency will deal with this dossier “with the utmost pace” and will continue work at Council Working Party level “to get the positions of Member States”, but also that the Maltese Presidency will first wait for the Committee vote on 30 May 2017 before “moving forward” on this file.

The Maltese EU Council Presidency ends on 1 July 2017, to be followed by Estonia for the second half of 2017.

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EU – EU Member States send letter to non-EU 92 countries in context of common EU list of non-cooperative tax jurisdictions

EU Member States sent a letter on 1 February 2017 to 92 jurisdictions outside the European Union, informing them that they will be “screened” with a view to possible inclusion in a future EU “blacklist” of tax havens. According to the EU’s tax policy calendar, the common EU blacklist should be ready by the end of 2017, which, given the task, seems quite ambitious.

The list of the 92 countries or jurisdictions that have been contacted is not public, but it is believed that the US or a couple of individual US States may have received a letter as well. The template for the letter signed by the Chair of the Code of Conduct Group on Business Taxation (the Code Group) was leaked. In the letter, EU Member States ask the recipients for main country contacts details and to cooperate with the EU. The letter insists that this first contact does not mean that the 92 countries will also end up on the EU's final list.

EU Member States' experts will soon be nominated in the context of the Code of Conduct Group as part of several country case-handling teams that will have to examine the 92 countries. The Code Group will possibly need to engage in a "dialogue" with each of the 92 countries to decide in the coming months whether they should be included in the final blacklist.

The European Commission finalised its work on a draft EU tax haven blacklist on 14 September 2016, or "Scoreboard of all third countries and jurisdictions for tax purposes (scoreboard)". The European Commission's scoreboard pre-assessed 160 non-EU jurisdictions against "objective economic, financial, stability and tax good governance indicators". The Commission presented the scoreboard on 15 September 2016. It is understood that the EU's 28 member states (Council) were informed of the scoreboard's publication only at a very late stage. However, importantly, the primary and formal responsible EU body for the EU screening process is actually the EU's Code Group, not the EU's Commission. To complicate matters further, the Code Group is not a formal EU body or EU/ECOFIN Council working group as such, but it is an informal, political peer pressure group made up of the EU Member States.

On 8 November 2016, the EU's ECOFIN Council (made up of the EU's 28 finance ministers) agreed that to avoid being on the future EU tax haven blacklist, third countries would have to comply with the international tax transparency criteria, fair taxation – including not facilitating offshore structures or arrangements aimed at attracting profits that do not reflect real economic activity in the jurisdiction, and implementation of anti-BEPS measures such as the common reporting standard. The work is being carried out in parallel with the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes.

Malta's Finance Minister Edward Scicluna, who is the chair of the ECOFIN Council as part of Malta's six-month rotating EU Council Presidency, told a press conference on 21 February 2017 after the ECOFIN Council meeting that: "There is no list at present whatsoever. What we have is a number of letters being sent to a number of jurisdictions asking them to engage with the EU in order to start discussions. ... Our aim is simple, to promote worldwide good standards that are already applicable in the European Union".

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Spain – European Commission requests Spain to amend its law implementing reporting obligations for certain assets located outside of Spain

On 19 February 2015, the European Commission notified the Kingdom of Spain of the initiation of an infringement procedure (number 2014/4330) following several complaints brought by different Spanish associations and individuals regarding the Spanish law of 29 October 2012 (the Spanish law) which implemented reporting obligations in connection with assets located outside of Spain through the Tax Form 720.

According to the Commission's letter to Spain dated 23 November 2015, the Commission announced the commencement of infringement proceedings against Spain with respect to the compatibility of two aspects of Spanish law with EU Treaties (free movement of citizens and free movement of capital). These aspects are i) the penalty regime and ii) the special statute-of-limitation period for the taxation of undeclared assets located outside of Spain. In March 2016, Spain filed contentions supporting the validity of these two aspects of the Spanish law.

On 15 February 2017, the Commission issued a reasoned opinion requesting Spain to amend its legislation regarding the penalty regime implemented due to the absence of declaration or incorrect declaration of assets located outside of Spain. The Commission stated that there are significant differences between the penalty regime in case of infringement of the obligation to declare assets located in other Member States and the penalties in case of infringement in a purely national situation. In this regard, the Commission considered that the penalties established are disproportional and much higher than those applying in a purely domestic situation. Therefore, the Commission concluded that these provisions are discriminatory and violate EU law.

If Spain does not amend its legislation within the two-month deadline given by the Commission, the case can be referred to the CJEU.

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Fiscal State aid

Luxembourg – Non-confidential version of the European Commission's State aid opening decision in GDF Suez

On 5 January 2017, the European Commission published its opening decision in the formal investigation into Luxembourg tax rulings obtained by entities of GDF Suez. The opening decision dated 19 September 2016 explains the reasons for the initiation of the formal investigation and the additional information requested from Luxembourg in order to reach a final conclusion. This decision represents, therefore, the opening, not the outcome, of the Commission's formal investigation into this matter.

The formal investigation pertains to the granting by Luxembourg of several tax rulings between 2008 and 2013 to several GDF Suez Luxembourg entities relating to the tax treatment of certain interest-free convertible instruments (ZORAs).

According to the description of the facts in the opening decision: GDF Suez Treasury Management Sarl and LNG Supply SA issued ZORA instruments to other Luxembourg group entities. The ZORAs were interest-free and automatically convertible into shares of the issuers at a conversion ratio determined based on the principal amount of the ZORAs. The principal amount was defined as being equal to a certain issuance value plus an annual accretion amount determined as a function of the net operational income of the issuer less a margin. The ZORA holders entered into prepaid forward sale agreements with other Luxembourg group entities in relation to the shares in which the ZORAs were convertible.

According to the opening decision, the tax treatment applied to the ZORAs was: the ZORA issuers deducted the annual accretion amount (recorded in their financial statements) from their taxable base on an annual basis, reducing their annual income to a margin determined as a percentage of the financial assets. The ZORA holders maintained the instruments at their acquisition value and, upon conversion, could defer the gain under the rollover provisions of Article 22bis of the Luxembourg Income Tax Law (LITL) (which provides that conversion of convertible loans into shares can benefit from a rollover relief, except for the capitalized interest related to the current year).

As part of the preliminary proceedings, Luxembourg supported the treatment as being fully in line with the Luxembourg tax provisions, detailing the technical arguments applicable at each level.

The Commission believes at this stage that the treatment applied to the entities involved in the financing arrangement can lead to State aid based on the following preliminary grounds:

- The Commission considers that the deductibility of the accretion amount on the ZORAs at the level of the ZORA issuers is not a correct application of two specific articles of the LITL which the Commission retains as being the framework of reference in this case (although the direct application to the case is not clear), as well as of the Luxembourg accounting rules; it questions in this respect the possibility for recognition of the annual accretion amount as a deductible expense and whether independent parties would have agreed to the terms of the ZORAs;

- As subsidiary arguments, the Commission considers that in a situation where the accretion amount could represent a deductible charge (i) it should have led to taxation in the hands of the ZORA holders; (ii) the calculation of the margin is not considered in line with the arm’s length principle; (iii) the application of the participation exemption at the level of the beneficiaries of the prepaid forwards is questioned on grounds of double non-taxation, as well as the application of the Luxembourg anti-abuse provisions, without detailed development of these arguments.

If the Commission's approach is confirmed in its final decision, further litigation before the European Courts is likely. According to the statement of the Luxembourg government issued on the same day with the publication of the decision, Luxembourg is confident that the allegations of State aid, in this case, are unsubstantiated and that it will be able to convince the Commission that no particular tax treatment or selective advantage was granted. The non-confidential version of the Commission's opening decision is available here.

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Spain – AG Opinion on tax exemptions for Church-run schools

The CJEU is currently examining whether the tax exemption to the Catholic Church in Spain in respect of construction works carried out on one of its school's buildings may constitute unlawful State aid. On the occasion of this procedure, the legal nature of the general subjective tax exemption of the Catholic Church deriving from the Agreement between Spain and the Vatican dated 3 January 1979 will be also examined.

On 16 February 2017, Advocate General (AG) Kokott rendered her Opinion on this case concluding that the tax exemptions for Church-run schools do not, as a general rule, contravene the State aid prohibition under Article 107(1) TFEU. Notwithstanding the above, it should be pointed out that, although EU Treaties require Member States to respect the status of churches (Article 17 TFEU), the AG stated that a distinction must be drawn between compulsory and voluntary education. In the AG's opinion:

- *compulsory* education is a non-economic activity in the context of the Church's social, cultural and educational mission and therefore EU competition law and the State aid prohibition is not applicable.
- *voluntary* education appears to be commercial in nature rendering the State aid prohibition applicable. Only where the voluntary education constitutes less than 10% of the relevant activity of the establishment, can it be considered ancillary to the economic activity.

Therefore, the AG is of the opinion that the tax exemption is not contrary to the State aid rules when the school premises are used by the Church for compulsory education purposes but may breach it where the school building is used mainly for providing educational services on a commercial basis.

Finally, the AG considered the scope of the agreement between Spain and the Vatican dated 3 January 1979 (i.e. before Spain's accession to the EU). The AG noted that insofar as the Agreement allows a margin of discretion, Spain should make use of its discretion in order to ensure compliance with its EU law obligations. Therefore, Spain, in consultation with the Vatican and going forward, would first have to make active use of the dispute-settlement mechanism in Article VI of the Agreement in order to achieve an interpretation of Article IV(1)(B) of the Agreement, which is compatible with EU law and in particular, with Article 107(1) TFEU. To the extent that a solution in conformity with EU law would not be achieved within a reasonable timeframe, Spain would have to give the Vatican its notice of termination of the Agreement.

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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 our clients identify and proactively manage EU State Aid risks.
- Together with our Financial Services colleagues, we have assisted foreign pension funds, insurance companies and investment funds with their dividend withholding tax refund claims.
- We have assisted clients before the CJEU and the EFTA Court in a number of high-profile cases such as *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.

More information

Please visit **www.pwc.com/eudtg**, or contact EUDTG Network Driver Bob van der Made (Tel.: +31 6 130 96 296, E-mail: bob.van.der.made@nl.pwc.com; or any of the contacts listed on the next page.

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