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EU Tax News

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CJEU Cases

Austria – CJEU's first judgment as court of arbitration in double tax treaty dispute

According to the double tax treaty between Austria and Germany (DTT), the Contracting States are obliged, at the request of the taxpayer, to submit the dispute to the CJEU under the arbitration procedure pursuant to Art. 273 TFEU, if the competent authorities do not reach agreement within three years in a mutual agreement procedure. The case concerned an Austrian bank, which acquired participation certificates from a German bank with the following conditions:

- The certificates confer entitlement to an annual payment at a fixed percentage of their nominal value;
- If the annual payment leads to an accounting loss, its amount is reduced accordingly;
- The certificates confer entitlement to payment of arrears over the course of subsequent years, provided that that adjustment does not give rise to an accounting loss;
- The payment of interest and the payment of arrears have priority over allocation to reserves and payments to guarantors/shareholders; and
- The certificates confer no right to participation in the proceeds from the winding up of the issuing company.

Even though Art. 3 para. 2 DTT sets out a rule of interpretation according to which a term not defined by that treaty must be given the meaning it has under the tax law of the State applying it, the CJEU ruled on 12 September 2017 (C-648/15) that the concept of "debt-claims with participation in profits" must be interpreted according to the methods proper to international tax law. According to the CJEU, the ordinary meaning to be given to the term "participation in profits", both everyday language and the most commonly accepted accounting conventions, refers to an acceptance which implies, in principle, the object of receiving a share in the positive income of the annual operations of an undertaking.

The CJEU further stated that the criterion allowing for derogation from the agreed allocation powers of taxation in Art. 11 para. 1 DTT must be given a strict interpretation. In the present case, the certificates are remunerated annually on the basis of a fixed percentage of their nominal value. It is true that the remuneration of those certificates is reduced or suspended when the financial year of the issuing company would end with a loss caused by that remuneration, with an adjustment being made subsequently in the course of the following beneficial years. Nevertheless, that particularity implies only that the annual payment of interest is affected by the presence of sufficient net profit for that financial year, and not that the certificates at issue confer entitlement, in addition to annual interest, to a share in those profits.

The concept of "debt-claims with participation in profits" referred to in Art. 11 para. 2 DTT must be interpreted as excluding certificates such as those at issue in the present case. Austria thus has the exclusive taxation right regarding to interest payments in connection with those certificates. Of note is that the CJEU did not decide on a refund of the German source taxation but referred the case back to the competent authorities in Austria and Germany to draw the proper inferences from the present judgment.

-- Rudolf Krickl, Richard Jerabek and Nikolaus Neubauer, PwC Austria; rudolf.krickl@pwc.com

Belgium – CJEU judgment on compatibility of interest payment deduction rules with Parent-Subsidiary Directive: *Argenta Spaarbank*

On 26 October 2017, the CJEU ruled on the compatibility of the Belgian interest payment deduction rules with the Parent-Subsidiary Directive (PSD) in the case *Argenta Spaarbank vs. Belgische Staat* (C-39/16).

The case concerns the Belgian interest payment deduction rules laid down in Art. 198(10) of the 1992 Income Tax Code as it existed before 2002. Under this rule, the deduction of interest payments was disallowed to the extent that in the same tax year the taxpayer had received exempt dividends from shares held for less than one year. The questions referred to the CJEU were whether the Belgian interest payments deduction rules are compatible with Art. 4(2) of the PSD, which determines the deduction of costs relating to a holding in a subsidiary established in another Member State and (former) Art. 1(2) of the PSD, by which Member States may refuse to grant the benefits of the PSD in order to prevent fraud and abuse.

In its judgment, the CJEU pointed out that Art. 4(2) of the PSD must be interpreted strictly meaning that it precludes a provision of domestic law pursuant to which interest paid by a parent company under a loan is not deductible from the taxable profits of that parent company up to an amount equal to that of the dividends received from the parent company's holding in its subsidiary even if such interest does not relate to the financing of the holding at hand. As pertains to Art. 1(2) of the PSD, the CJEU highlighted that this provision reflects the general EU law principle of a prohibition of abuse of rights. It then decided that Art. 1(2) of the PSD must be interpreted as not authorising Member States to apply a domestic provision to the extent that such provision goes beyond what is necessary for the prevention of fraud and abuse.

Because the CJEU decided that the PSD is applicable in the case at hand precluding the Belgian provision, the judgment can be regarded as further limiting the leeway Member States have in exercising the options available to them under Art. 4(2) of the PSD.

-- Patrice Delacroix, Pieter Deré and Paulina Szotek, PwC Belgium; patrice.delacroix@pwc.com

Germany – CJEU referral on compatibility of German limitation of deductibility of special expenses for non-residents with the freedom of establishment: *Montag*

On 3 August 2017, the Fiscal Court of Cologne referred a case (C-480/17) to the CJEU concerning the German limitation of the deductibility of special expenses for non-residents (contained in sec. 50 para. 1 sentence 3 German Income Tax Act (ITA) 2008).

In the case at hand, the plaintiff had his residence and habitual abode in Belgium where he was subject to unlimited Belgian income tax. In order to work as a European lawyer in Belgium, he was registered with a German bar association, was a compulsory member of the lawyers' pension fund in North Rhine-Westphalia and had to pay annual fees to both. Furthermore, he paid non-compulsory fees to the lawyers' pension fund and to a private pension fund. The plaintiff generated income from his activities as a lawyer in multiple Member States. More than half of his income was generated in Germany and subsequently taxed in Germany (non-resident taxation).

The competent fiscal authority denied a deduction of the annual fees payable to the German bar association and the German pension fund as well as the deduction of the additional non-compulsory fees, claiming that the deduction of special expenses for non-residents is prohibited by law (sec. 50 para. 1 sentence 3 ITA 2008). Furthermore, a deduction of those expenses was also not possible in Belgium.

The Fiscal Court of Cologne expressed doubts as to whether the non-deductibility of such special expenses for non-residents in Germany according to sec 50 para. 1 sentence 3 ITA 2008 is in line with the freedom of establishment (Art. 49 TFEU). This is based on the fact that a tax resident who is liable to unlimited taxation in Germany is able to deduct the compulsory annual fees to a certain degree. Furthermore, the Fiscal Court of Cologne questions whether limiting a deduction of additional non-compulsory fees to (private) pension funds is in line with the freedom of establishment, if later pension payouts are taxed at the level of non-residents.

-- Arne Schnitger and Ronald Gebhardt, PwC Germany; ronald.gebhardt@pwc.com

Germany – CJEU judgment on compatibility of German deduction of special expenses with the freedom of movement for workers: *Bechtel*

On 22 June 2017, the CJEU rendered its judgment in Bechtel (C-20/16). It concluded that the German rule, prohibiting the deduction of special expenses, violates the freedom of movement for workers (Art. 45 TFEU), if such expenses have a direct economic link with tax-exempt income (sec. 10 para. 2 sentence 1 no. 1 ITA 2008).

In the case at hand, the plaintiffs were married and resided in Germany where they were subject to joint assessment for income tax purposes. In 2005 and 2006, the husband received income from his salary as a government employee of Germany. The wife, a French national, received income from her salary as a government employee of the French tax authority. Her gross income was reduced by, among others, contributions in France to additional health and disability insurance, survivors' pensions, employee contribution for health insurance and additional pension contribution for the public sector.

According to Art. 14(1) and Art. 20(1)(a) of the French-German tax treaty, the wife's income from her employment in France has to be excluded from their joint German income tax base. Accordingly, the German fiscal authority denied the deduction of special expenses.

The CJEU reconfirmed its previous jurisprudence by holding that a resident taxpayer receiving income in another Member State is not in a comparable situation to that of a resident taxpayer receiving domestic income, if the state of residence exempts the foreign income under a tax treaty. However, in the case at hand, the CJEU made a distinction: due to the joint tax assessment, Germany was able to grant the wife the advantages resulting from taking into account her personal or family circumstances, such as the deductions of the contributions at issue, despite her not having significant income in Germany. Thus the CJEU found the situation of the taxpayer to be comparable to that of a resident receiving domestic income. According to the CJEU such disadvantageous treatment could constitute a restriction on the free movement of workers, which is prohibited by Art. 45 TFEU.

-- Arne Schnitger and Ronald Gebhardt, PwC Germany; ronald.gebhardt@pwc.com

Netherlands – AG Opinion on compatibility of Dutch fiscal unity regime with fundamental freedoms, and the Dutch Government's emergency response measures

On 25 October 2017, AG Campos Sánchez-Bordona issued his opinion in *X BV & X NV v Staatssecretaris van Financiën* (Joined Cases C-398/16 and C-399/16). These cases, which were referred to the CJEU by the Dutch Supreme Court in July 2016, relate to the consequences of the 'per element' approach, as established by the CJEU in *Groupe Steria* (C-386/14).

Case C-398/16 (interest deductibility)

This case dealt with the non-deductibility of interest on a loan received by a Dutch company from a Swedish company, which is part of the same group of companies, to equity finance a non-resident shareholding. The non-deductibility results from the application of Art. 10a of the 1969 Dutch Corporate Income Tax Act (CITA). Within a fiscal unity pursuant to Art. 15 of the Dutch CITA, the capital contribution would not be visible and as a result, the rule would not be applicable. The AG opined in favour of the taxpayer. First, in line with the CJEU's judgments in *X Holding* (C-337/08) and *Groupe Steria* (C- 386/14), the AG concluded that the two situations were objectively comparable as they concerned the financial costs borne by the parent company related to its holding in a subsidiary, regardless of whether or not there is a fiscal unity. The AG concluded that the two comparable situations were treated differently which amounted to a restriction on the fundamental freedoms. The AG did not accept the Netherlands' justifications regarding the need to maintain the coherence of the fiscal unity regime and the need to prevent tax evasion.

Case C-399/16 (currency losses)
This case concerned a Dutch company, which was part of a fiscal unity regime in the Netherlands and which held the shares of a UK subsidiary. These shares were subsequently contributed to another UK subsidiary. As a result of exchange rate fluctuations, the Dutch company incurred a currency loss on its contributed UK subsidiary, the deduction of which was denied by the Dutch tax authorities under the participation exemption. The taxpayer claimed that, had it been permitted to form a fiscal unity with its UK subsidiary, it would have been able to deduct the currency loss incurred. Because the right to enter in a fiscal unity was however reserved for Dutch resident companies (and Dutch PEs of non-residents), the taxpayer argued that its freedom of establishment (Art. 49-54 TFEU) had been restricted. The AG recognized a difference in treatment, stating that a parent company established in the Netherlands cannot take into account a currency loss in connection with the amount which it has invested in a subsidiary established in another Member State whereas it would be able to do so if that subsidiary was part of a fiscal unity. However, the AG reached the same conclusion as the CJEU in *X AB (*C-686/13*)* that the Dutch rule is symmetrical, meaning that insofar as currency gains are disregarded, currency losses may also be disregarded.

On the same day, the Dutch Government immediately announced several emergency response measures in the event that the CJEU follows the AG's Opinion. These measures amount to applying certain provisions within the Dutch CITA and the Dutch Dividend Withholding Tax Act within a fiscal unity as if such fiscal unity was not present. As a result, the existing favourable treatment for domestic situations is intended to be eliminated. These measures will take effect per 25 October 2017 subject to the CJEU's judgment.

-- Hein Vermeulen and Mart van Hulten, PwC Netherlands; hein.vermeulen@pwc.com

Sweden – CJEU referral regarding final losses in indirectly held subsidiaries

On 5 October 2017, the Swedish Supreme Administrative Court (SAC) referred questions to the CJEU for preliminary rulings (SAC case number 5544-16).

The case concerns a Swedish parent company with operations in *inter alia* Spain, where it operated through several subsidiaries and through a branch. The Spanish operations had suffered losses, and the Swedish parent intended to leave the Spanish market (either through a sale to a third party combined with liquidations and/or mergers) and asked for a ruling on whether the Spanish tax losses (in both directly and indirectly held subsidiaries) could be utilized in Sweden. If the Spanish entities had been Swedish, it would have been possible for the Swedish parent to utilize the losses. Under Swedish tax law, however, this is not possible in respect of the Spanish losses.

The SAC notes that although the case *Marks & Spencer* (C-446/03) factually concerned losses in indirectly held subsidiaries, considering that this fact was not explicitly discussed by the CJEU either in *Marks & Spencer* or in any other CJEU case, the SAC requests guidance from the CJEU on whether is it possible to deduct final losses in indirectly held subsidiaries. If the response to that question is positive then the SAC also asks for clarifications regarding when the losses would be considered final.

-- Fredrik Ohlsson, PwC Sweden; fredrik.ohlsson@pwc.com

Sweden – CJEU referral regarding final foreign losses

On 5 October 2017, the Swedish Supreme Administrative Court (SAC) referred another final losses case to the CJEU for clarification (SAC case number 4165-16).

The case concerns a cross-border merger between a loss-making German subsidiary and a Swedish parent company. The Swedish group intended to leave the German market. Under Swedish tax law, it is not possible to take over foreign losses through a merger. The SAC noted that in the case *A Oy* (C-123/11), the CJEU concluded that this position could in certain cases contravene the freedom of establishment.

According to the available information, it would not be possible for a German company to transfer its tax losses to another German company through a merger. The question then is if the tax losses in the German subsidiary would be considered as final or not. The SAC is of the view that this matter has not been dealt with by the CJEU yet and therefore asks for a clarifying ruling. When assessing whether a loss is final or not, the SAC asks what the consequences are if the tax rules in the country in which the subsidiary is resident impose restrictions on loss deductibility for companies other than the loss making company. If the CJEU is of the view that these restrictions should be taken into account, the SAC also requires clarification on whether it makes a difference if there is any other company in the country in which the loss making entity is resident at the level of which the losses could have been taken into account.

-- Fredrik Ohlsson, PwC Sweden; fredrik.ohlsson@pwc.com

United Kingdom – CJEU judgment on taxation of transactions for the raising of capital: *Air Berlin Plc*

In this case (C-573/16), the CJEU concluded in favour of Air Berlin that a transfer of shares into a clearing services in the course of a listing transaction should not be subject to stamp duty reserve tax. Air Berlin had argued that EU law prohibited the 1.5% UK tax that the business paid when transferring their shares to a clearing service in 2006 in order to make an initial public offering and subsequently when they wanted to list additional new shares. The

CJEU decided on 19 October 2017 that Articles 10 and 11 of Directive 69/335/EEC and Article 5(1)(c) of Directive 2008/7/EC do indeed prohibit the taxation of transactions for the raising of capital and should be applied to the Air Berlin situation. Both the transfer of shares to the clearing service and the subsequent transfer of shares to enable listing were both regarded by the CJEU as integral to the steps required to raise capital and therefore should not have been subject to tax. PwC represented the taxpayer, who stands to win about £5m from the UK Government when the case returns to the national court.

-- Jonathan Hare and Juliet Trent, PwC UK; jonathan.hare@pwc.com

United Kingdom – CJEU judgment on the application of UK capital gains tax on a deemed disposal of all of the assets of a trust: *Trustees of the P Panayi Accumulation & Maintenance Settlements*

This case (C-646/15) considered the application of UK capital gains tax on a deemed disposal of all of the assets of a trust when the majority of the trustees became resident outside the UK precipitating UK exit tax provisions. The CJEU decided that this tax charge was incompatible with the freedom of establishment.

Underpinning this decision was the conclusion that trusts (and their trustees) fall within the meaning of 'other legal persons' within Art. 54 TFEU (the definition of 'companies or firms') as they are entities which, under national law, possess rights and obligations; further, the exclusion for non-profit-making did not apply, as the trusts were created so the beneficiaries might enjoy the profits generated from the trusts' assets. The UK trust exit charge provisions discouraged trustees from transferring the place of management outside the UK and from appointing non-UK resident trustees and therefore constituted a restriction on freedom of establishment. The charge was in principle justified by the preservation of balanced allocation of taxing powers because the UK lost its power to tax unrealised capital gains of the trust following the transfer of its place of management to another Member State. However, the CJEU distinguished other cases allowing exit taxation (such as Case C-371/10 *National Grid Indus*), holding that the UK trust exit charge provisions were not proportionate to that objective because they provided only for the immediate payment of the tax, without giving the taxpayer any choice to defer payment.

-- Jonathan Hare and Juliet Trent, PwC UK; jonathan.hare@pwc.com

United Kingdom – CJEU judgment on the UK tax treatment of foreign income dividends: *Trustees of the BT Pension Scheme*

This case (C-628/15) concerns the incompatibility with the TFEU of the UK tax treatment between 1994 and 1999 of 'foreign income dividends' (FIDs) – dividends paid by a UK-resident company and sourced out of certain dividends received by the UK-resident company from non-UK resident companies. The question in issue was whether the shareholders have an EU law right to payment of a tax credit under the free movement of capital provisions.

Treatment of a dividend as a FID was by election of the paying company (provided that certain detailed conditions were satisfied), and permitted the dividend-paying company to obtain repayment of advance corporation tax on the dividend, but had the effect that a tax-exempt shareholder receiving the dividend was not entitled to the repayable tax credit which was generally due in respect of other dividends received from UK-resident companies.

In *FII* (C-446/04), the CJEU held in favour of the UK dividend-paying companies that Art.63 TFEU (the prohibition of restrictions on free movement of capital) precluded these provisions in that they discouraged the dividend-paying companies from investing in non-UK companies. However, the question raised in the present case was whether EU law conferred any rights on the shareholders (the pension fund trustees) to repayment of the credit which would have been payable on a normal UK dividend other than a FID.

The UK argued that the trustees could not rely on the free movement of capital, inter alia because their investment was in UK-resident companies (the dividend-paying companies) and therefore did not involve any movement of capital between Member States. The CJEU confirmed that free movement of capital does not apply to situations confined in all respects within a single Member State. However, this was not the situation here, as the FIDs regime applied only to dividends having their origin in profits received by the UK dividend-paying company from a *non*-UK-resident company.

The UK also argued that Art.63 TFEU did not give the pension fund trustees any right to a refund because they were exempt from income tax on the dividends and therefore had not paid any tax on them. However, the CJEU held that the *San Giorgio* (C-199/82) right to repayment of charges levied contrary to EU law concerns not only amounts paid to a Member State by way of unlawful charges, but also any refund which restores the equal treatment required by the EU free movement provisions – including consequently the amounts due to an individual in respect of a tax credit of which he has been deprived under national law precluded by EU law. Therefore the trustees were entitled to the tax credit of which they had been deprived under UK law. The national court was required to disapply the provisions which denied the credit, and ensure that the trustees had an effective remedy guaranteeing payment of the tax credit under no less favourable rules than those applicable to normal UK dividends. In addition the CJEU held that it was irrelevant whether the dividend-paying company had increased the amount of the dividend to compensate for the absence of a tax credit; it did not consider the additional payment of the tax credit would result in double recovery by the trustees.

-- Jonathan Hare and Juliet Trent, PwC UK; jonathan.hare@pwc.com

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National Developments

Norway – EFTA Court advisory opinion opens door to cross-border group contributions with tax effect

On 13 September 2017, the EFTA Court rendered its Advisory Opinion in the case *Yara International ASA vs. the Norwegian Government* (E-15/16) concerning the Norwegian intra-group contribution rules. Under these rules, the group contribution reduces the transferor's taxable income and is included in the recipient's taxable income regardless of whether the recipient makes a loss or a profit for tax purposes. However, the rules require that both the transferor and the recipient are liable to taxation in Norway.

This condition entailed, in Yara's case, that Yara was denied a tax deduction for group contributions to its Lithuanian subsidiary that was later liquidated. The EFTA Court concluded that the Norwegian rules infringe the freedom of establishment protected by Art. 31 EEA when they deny Norwegian companies a tax deduction for group contributions to a group company in an EEA state with a tax loss in that state, and the loss incurred by the foreign group company is final. The parties agreed that the condition constituted a restriction under Art. 31 EEA, but that it may be justified by overriding reasons in the public interest and that it is appropriate to attain a legitimate objective. The issue at stake was however the extent to which this condition is proportionate.

The EFTA Court found that as for the proportionality test, there is no reason to distinguish between the different schemes of tax consolidation, such as loss transfers (group relief) under UK tax law (e.g. *Marks & Spencer* C-446/03) and profit transfers (group contribution schemes) as in Norwegian and Finnish law (e.g. *Oy AA* C-231/05). What is decisive is whether the restriction is appropriate to ensure the attainment of a legitimate objective, such as safeguarding the balanced allocation of taxing powers between EEA States, and that it does not go beyond what is necessary to attain that objective. The EFTA Court concluded that, when the intra-group contribution is made to cover a "final loss" in a foreign group company, the purpose of maintaining the balanced allocation of taxing power cannot justify the restriction.

It is for the national court to determine whether the loss is final, the situation could be considered a wholly artificial arrangement, and a deduction could be denied on those grounds.
-- Cecilie Beck Landet and Sander Seeberg, PwC Norway; cecilie.beck.landet@pwc.com

Norway – Amendment to the group contribution rules

In the national budget for 2018 presented on 12 October 2017, the Norwegian Ministry of Finance proposed an amendment to the group contribution rule. The amendment entails that group contributions can be made to a Norwegian branch of an EEA company with uncovered losses after the cessation of tax liability in Norway.

As a starting point, the group contribution rules apply between Norwegian tax resident companies. Subject to certain requirements (i.e. tax liability in Norway), group contributions may be rendered to/from Norwegian branches of EEA companies, as well as branches of companies from certain other states based on tax treaties.

The Norwegian tax authorities have interpreted the requirement of tax liability in Norway to mean that an EEA branch must have taxable business activities in Norway in the year in which it receives a group contribution in order for it to have tax effect. This has resulted in a difference in treatment of EEA companies with Norwegian branches with tax losses carried forward, compared to Norwegian companies in a comparable situation.

Thus, the Ministry proposed to introduce a rule that the company rendering the group contribution is entitled to deductions for the group contribution when the recipient company within the EEA area has tax losses carried forward from previous business activities in Norway. The recipient company must reduce its tax losses carried forward correspondingly. The Ministry concludes that through this amendment any uncertainty with respect to whether the current rules are in line with the freedom of establishment under the EEA Agreement should be eliminated. The amendment is proposed to enter into force with effect as from 1 January 2018.

-- Cecilie Beck Landet and Sander Seeberg, PwC Norway; cecilie.beck.landet@pwc.com

Sweden – Dividend tax rule deemed incompatible with EU law

Under Swedish tax law, dividends constitute taxable income for individuals. Only an amount of 5/6th of a dividend is taxable if the dividend comes from an unquoted Swedish limited liability company. The same applies to dividends from unquoted foreign companies but only insofar as that company is subject to a level of taxation that is deemed to be comparable to the Swedish one. If that latter criterion is not met, then the entire dividend constitutes taxable income for the individual.

A Swedish individual received a dividend from an unquoted Cypriot company in 2011. At that point in time, the corporate income tax rate in Sweden was 26.3% while the Cypriot corporate income tax rate was 10%. The Swedish Tax Agency (STA) considered that the tax rate in Cyprus was not comparable to the Swedish one and therefore decided that the entire dividend constituted taxable income for the individual.

The Supreme Administrative Court (SAC) of Sweden ruled on 16 October 2017 (SAC case number 6322-16) concluding that the STA's decision was not in line with EU law. Requiring the Cypriot tax rate to be comparable to the Swedish one in fact imposes a restriction on the free movement of capital. Such requirement could not be justified as it did not target only wholly artificial arrangements. The STA's argument that the rule could be justified with the argument that it would serve the balanced allocation of taxing powers between Member States was not accepted by the SAC either. The tax payer therefore won the case and only 5/6th of the dividend constituted taxable income for the individual.

-- Fredrik Ohlsson, PwC Sweden; fredrik.ohlsson@pwc.com

United Kingdom – Court of Appeal in Routier v HMRC regarding the UK definition of 'charity' and its compatibility with the free movement of capital

In this case, legacies given by a UK testator to two Jersey charities did not qualify for an inheritance tax exemption as charitable gifts because the charities, being in Jersey, were not subject to the supervision of the UK courts. The main issue was whether limiting the definition of 'charity' to mean a UK charity was an unlawful restriction on the free movement of capital.

HMRC argued first that Jersey was part of the UK for the purposes of the EC Treaty, and so the legacies were confined to a single Member State (UK-to-UK). However, the Court of Appeal concluded with reference to Art. 299(6)(c) of the EC Treaty (now Art. 355(5)(c) TFEU) that Jersey should be considered to be a third country for the purposes of the free movement of capital provisions of the TFEU. Unlike Gibraltar under Art.355(3) TFEU (see C-591/15 *Gibraltar Betting and Gaming Association Ltd*), Art. 355(5)(c) provides that the Treaty applies to the Channel Islands and the Isle of Man only to the extent set out in the 1972 Accession Treaty; and Protocol No.3 to the Accession Treaty provides that customs rules apply to them as they do to the UK, but that the Channel Islands cannot benefit from the free movement provisions. Therefore for this purpose, the Channel Islands fell to be treated as third countries.

It followed that Art. 63 TFEU applied to gifts from a UK resident to a Jersey trust as movements of capital from the UK to a third country, and so the limitation of the definition of 'charity' to a UK charity for the purposes of the exemption for charitable gifts was a restriction on the free movement of capital. However, since at the time of the gifts there was no mutual assistance agreement for provision of information between Jersey and the UK in relation to inheritance tax (and the mutual agreement made in 2009 did not apply retrospectively for purposes of inheritance tax on gifts made earlier), the UK had no means of compelling the provision of information to verify reliably whether the Jersey charity would have satisfied the conditions to qualify as a charity in the UK and thus for the gifts to qualify for exemption. Therefore the restriction on the free movement of capital was justified on grounds of effective fiscal supervision.

-- Jonathan Hare and Juliet Trent, PwC UK; jonathan.hare@pwc.com

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EU Developments

EU – European Commission issues Communication on the taxation of the digital economy

On 21 September 2017, the European Commission issued a Communication (non-binding, strategic policy paper) on the taxation of the digital economy. The Communication calls for a common EU approach with a view to ensuring "fair and effective taxation across the Digital Single Market". The Commission also announced that it will likely present a draft proposal for an EU Directive in spring 2018. This new agenda is, according to the Commission, complementary to other initiatives aimed at tackling aggressive tax planning and enhancing tax transparency.

The Commission highlights that the existing international tax framework, based on which the nexus with a particular jurisdiction is determined, using the so called "bricks and mortar" requirements, does not sufficiently cover digital companies. Having regard to the underlying principle of taxing profits where value is created, the Commission identifies two main policy challenges in this respect. First, the appropriate nexus should be determined where digital service providers perform services and have commercial presence in a tax jurisdiction with no or limited physical presence therein. Second, the attribution of profits based on digitized business models relying on intangible assets, knowledge and data should also be addressed. The Commission is of the view that the Common Consolidated Corporate Tax Base (CCCTB), which uses the formula apportionment method based on assets, labour and sales, adequately reflects where value is created. The Commission also remarks that there is scope in the CCCTB proposal to examine further enhancements to ensure that digital activities are effectively covered.

Alongside this longer-term strategy, the Commission also put forward some alternative solutions for more immediate action at the EU and international level such as:

- an equalization tax on turnover of digitalized companies;
- a withholding tax on digital transactions;
- a levy on revenues generated from providing digital services or advertising activities.

While the Communication outlines the challenges faced by policymakers and potential solutions to taxing the digital economy in the EU, the EU's medium to longer-term course of action seems to depend in large part on the OECD's forthcoming spring 2018 report to the G20 on the digital economy. However, there appears to be strong political will amongst at least 10 EU Member States led by Germany and France, supported by the EU Parliament and the Commission, to pursue an intermediate, EU-only approach in parallel (perhaps including 'quick fixes'), should the developments at the international level prove insufficient.

On 26 October 2017, the Commission launched a public consultation on Fair Taxation of the Digital Economy which will run until 3 January 2018. The Commission also published an Inception Impact Assessment accompanying the public consultation the next day. The Commission stated that an impact assessment is being prepared to support the preparation of the Commission's taxation of the digital economy proposal which is scheduled to be finalized in March 2018.

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

EU – Directive on Tax Dispute Resolution Mechanisms formally adopted

On 10 October 2017, the ECOFIN Council formally adopted a Directive on tax dispute resolution mechanisms in the EU with the objective of establishing a more effective and efficient procedure to resolve disputes within the EU. The Directive builds on the existing Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (EU Arbitration Convention).

The Directive applies to those disputes arising from the interpretation and application of agreements and conventions that provide for the elimination of double taxation of income and, where applicable, capital.

Any person who is a resident of an EU Member State for tax purposes and whose taxation is directly affected by a matter giving rise to a dispute may, within three years from the receipt of the first notification of the action resulting in or that will result in the dispute, submit a complaint simultaneously to each of the concerned EU competent authorities. Any of the concerned competent authorities may, within a period of six months from having received all the necessary documents, decide to resolve the dispute on a unilateral basis. If that is not the case, the Member States concerned shall endeavour to solve the dispute by means of a mutual agreement procedure (MAP) within a period of two years. If the Member States reach an agreement under the MAP within the stipulated timeframe, this will be binding on the competent authorities and enforceable by the taxpayer subject to his acceptance of the agreement. If the Member States fail to reach an agreement under the MAP, the concerned competent authorities will inform the taxpayer of the reasons thereto.

In the latter case, upon a request by the taxpayer to the competent authorities of the Member States concerned, an Advisory Commission, consisting of three to five independent arbitrators and up to two representatives of each Member State, shall be set up. The Directive provides Member States with the flexibility to set up an Alternative Dispute Resolution Commission instead of the Advisory Commission. The Directive provides for appeal possibilities for taxpayers to ensure that the competent authorities will apply the provisions of the Directive.

By providing a mandatory and binding dispute resolution mechanism with improved access and increased involvement for the taxpayer, clear and shorter timeframes and an obligation for the Member States to reach a solution, the Directive will be a significant improvement to the existing rules. Member States must implement the Directive into their national laws by 30 June 2019 at the latest. It will apply to any complaint submitted from 1 July 2019 onwards relating to disputes concerning income or capital earned in a tax year commencing on or after 1 January 2018.

-- Edwin Visser, Bob van der Made and Erisa Nuku, PwC Netherlands; edwin.visser@pwc.com

EU – European Council President Tusk's new EU reform plans

On 18 October 2017, European Council President Tusk proposed his new EU "Leaders' Agenda" to the EU-28's leaders ahead of the EU summit held during the following two days. Tusk wants the EU-28 heads of state and government to get more actively involved at the highest political level "to break any deadlock" in Council (i.e. in the lower, law-making Council of Ministers), which would also include creating a short-cut to enhanced cooperation "if that's the only way forward".

A minimum of nine participating EU Member States in favour of introducing an EU proposal, only among themselves, can do so through enhanced cooperation. The first experiment with enhanced cooperation in the area of taxation is with the EU financial transaction tax, but this has so far proved to be an extremely difficult process going on for five years without, so far, a final agreement in sight. The formal EU law requirements for enhanced cooperation are laid down in Art. 20 of the Treaty on European Union (TEU) and Art. 326 to 334 TFEU.

Tusk's Leaders' Agenda provides an overview of the main issues that he intends to put to EU leaders between now and June 2019. Some will be discussed at formal EU summits, while others will be addressed in an informal format, with 27 or 28 EU leaders, depending on the substance. The Leaders' Agenda includes ongoing work streams and issues that require discussions aimed at resolving deadlocks or finding solutions to key political dossiers. It may be that Tusk's plan, if accepted by EU Leaders, could also impact deadlocked EU tax-related dossiers in Council.

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

EU – Tallinn European Council Conclusions of 19 October 2017

The Tallinn European Council held on 19 October 2017 adopted European Council Conclusions on migration, digital Europe, security and defence. On taxation of the digital economy EU-28 Leaders concluded: "an effective and fair taxation system fit for the digital era: it is important to ensure that all companies pay their fair share of taxes and to ensure a global level-playing field in line with the work currently underway at the OECD. The European Council invites the Council to pursue its examination of the Commission communication on this issue and looks forward to appropriate Commission proposals by early 2018."

Also of note:

"Our objective must be to create a more integrated Single Market and to deliver practical benefits for European citizens and businesses. The European Council will closely follow developments in this area and provide the necessary guidance. It calls on the institutions to step up the legislative work, and on the Member States to implement the relevant EU legislation and to take all the measures required within their sphere of competence so as to shape the new digital era. The European Council will at its level address issues that cannot be solved at the level of the Council."

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

EU – European Commission adopts Work Programme for 2018

Every year the Commission adopts its Work Programme setting out the list of actions it will take in the year ahead. The Work Programme (WP) informs the public and the EU's co-legislators (EU's Council and Parliament) of the Commission's political commitments to present new initiatives, withdraw pending proposals and review existing EU legislation.

The focus of the Commission's WP 2018 presented on 24 October 2017 is two-fold. First, the WP sets out a limited number of targeted legislative actions to complete its work in priority policy areas over the next months. The Commission also stated that it will table all legislative proposals no later than May 2018. Secondly, the WP also presents a number of initiatives that have a more forward-looking perspective, as the new Union of 27 shapes its own future for 2025. These initiatives reflect the debate kick-started by the Commission's White Paper on the Future of Europe and the State of the Union address.

The Commission's WP 2018 says that: "To be stronger, Europe also has to be more efficient. It must be able to act more quickly and decisively in a range of policy areas so that citizens and businesses benefit more immediately from EU law. The Commission will therefore outline how the EU could make use of the so- called 'passerelle clauses' in the current Treaties which allow us to move from unanimity to qualified majority voting in certain areas if all Heads of State or Government agree to do so. We will do this for internal market matters, as well as for certain foreign policy decisions to ensure the Union is a strong global actor with real weight in the world, while paying particular attention to the consistency and efficiency of these decisions."

Highlighted in Annex I as "new initiatives" relating to "A deeper and fairer Internal Market with a strengthened industrial base" and direct tax:

- Fair taxation in the digital economy – Proposal establishing rules at EU level allowing taxation of profits generated by multinationals through the digital economy (legislative, including impact assessment, Art.113, 115 TFEU, Q1 2018)
- More efficient Single Market law-making (initiative to be launched with a 2026 perspective) – Communication on the possibility of further enhancing the use of

qualified majority voting and legislative procedure in internal market matters on the basis of Art. 47(7) TFEU (non-legislative, Q3 2018)

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

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Fiscal State aid

EU – European Commission takes next steps against Ireland and Luxembourg in Apple and Amazon State aid cases

On 4 October 2017, the European Commission continued its ongoing challenges to Member States' transfer pricing tax regimes by advancing two high profile cases to the next stages. In the Apple case, the Commission referred Ireland to the CJEU for failing to enforce an August 2016 State aid recovery decision. In the Amazon case, the Commission announced its conclusion that Luxembourg's tax treatment of Amazon gave rise to unlawful State aid.

The Commission has had an increased focus on tax cases since 2013 where it considers that possible State aid may have been granted by a number of EU Member States, most prominently Luxembourg, Belgium, the Netherlands, and Ireland. The case against Ireland with regard to Apple was launched in June of 2014. The Commission's final decision was rendered on 30 August 2016 concluding that Ireland had granted unlawful State aid to Apple estimated in the amount of up to EUR 13 billion and that this amount together with compound interest should be recovered immediately. Ireland lodged its appeal to the European courts against the decision on 9 November 2016, and Apple appealed on 19 December 2016. An appeal does not automatically suspend recovery proceedings and the Commission's action signals its unwillingness to allow Ireland more time to complete the collection process despite acknowledged difficulties.

If the CJEU finds that Ireland has failed to fulfil its obligations under the EU Treaties, Ireland will be required to take the necessary measures to comply with the CJEU's judgment. Failure to do so could expose Ireland to possible penalty payments.

The case against Luxembourg with regard to Amazon was launched in October 2014. The decision announced on 4 October concludes that Luxembourg granted unlawful State aid to Amazon in the amount of up to EUR 250 million. The Commission decision challenges the transfer pricing method that was used to calculate royalty payments from Amazon EU, a Luxembourg tax resident company, to Amazon Europe Holding Technologies (AEHT), a Luxembourg partnership. The royalties were paid with respect to intellectual property rights paid for and owned by AEHT under a cost sharing agreement. The next step for the

Luxembourg-Amazon case will depend on whether the decision is appealed, which seems likely. In the meantime, however, Luxembourg will be required to effectuate recovery of the amount identified as unlawful aid by the Commission.

-- Alina Macovei, PwC Luxembourg, Dennis Harington, PwC Ireland, and Jonathan Hare; alina.macovei@lu.pwc.com, denis.harrington@ie.pwc.com, jonathan.hare@pwc.com

Netherlands – Court of Appeal refers preliminary questions on possible State aid to the CJEU

On 12 October 2017, the Dutch Court of Appeal referred preliminary questions to the CJEU relating to the possible presence of State aid resulting from a refund of Dutch dividend withholding tax which the Dutch Court of Appeal ordered on the basis of the free movement of capital (Art. 63 TFEU).

The case concerns a German public law legal entity (Sparkasse), established in Germany, which invests through a German contractual investment fund which has the form of a Spezial-Söndervermogen (Fund), in shares of Dutch companies. The Fund considers itself comparable to a non-transparent Dutch contractual investment fund, which under certain conditions is effectively eligible for a refund of Dutch dividend withholding tax. Therefore, the Fund has requested a refund of the Dutch dividend tax for the years 2003 and 2004 on the basis of the free movement of capital.

The Dutch Court of Appeal notes that the Dutch tax authorities have stated that should the CJEU rule that the German public law legal entity is entitled to a refund, such refund would be in breach of the State aid provisions (Art. 107-108 TFEU). In this respect, the Dutch tax authorities note that the Dutch regulation, pursuant to which Dutch public law legal entities were entitled to a refund of Dutch dividend withholding tax at the relevant time (2003 and 2004), was considered an existing aid measure and subsequently amended in 2016 after the European Commission considered it to be in breach of the internal market. According to the Dutch tax authorities, providing a refund of Dutch dividend withholding tax to the Fund would result in an amendment of that existing aid measure and thus constitute new aid. That would - according to the Dutch tax authorities - be in breach of Art. 108(3) TFEU which provides that the Commission shall be informed of any plans to grant or alter aid.

This argument raised by the Dutch tax authorities provides the reason for the Dutch Court of Appeal to refer the following preliminary questions to the CJEU:

1. Under EU law, should the extension of the scope of an existing aid measure, as a result of a successful appeal by a taxpayer to the right of free movement of capital, be considered as a new aid measure?
2. If so:

- does the duty of the national court by virtue of Article 108(3) of the TFEU prevent the taxpayer from being granted a tax benefit to which the taxpayer is entitled to pursuant to the free movement of capital; or
- should the Commission be informed of an intended decision of the national court to grant that tax benefit; or should the national court have to take any other action or implement measures?

In relation to the requests for Dutch dividend withholding tax filed on the basis of EU law, we note that this case is, in particular, relevant for contractual investment funds with one investor and for non-Dutch public law legal entities. We therefore expect that the outcome of this case is relevant for refund requests filed in particular situations only.

-- Hein Vermeulen and Mark van Graafeiland, PwC Netherlands; hein.vermeulen@pwc.com

Spain – Supreme Court resolution about Spanish tax on immovable property

In 2015, the Council of A Coruña approved an amendment of the local regulations referring to the Spanish tax on immovable property introducing:

- an increase of the tax rate applied to special immovable property (airports, harbours, etc.);
- a 50% tax rebate for commercial harbours that develop activities declared of special interest or municipal utility, considering among them those activities referred to the fishing industry (extraction, production, commercialization and transformation of fishing products).

In this regard, the Spanish Supreme Court has recently issued a reasoned resolution admitting the appeal brought by the company that manages a convention centre in the city, which is among the large number of taxpayers excluded from the scope of the tax rebate. Referring to the CJEU case *Ministerio de Defensa y Navantia* (C-522/13), the Spanish Supreme Court states that by privileging certain activities (those referring to the fishing industry), which are carried out in certain places (e.g. commercial harbours), the Council could have established a tax incentive in breach of the EU law State aid provisions. It remains to be determined whether the tax rebate established by the Council of A Coruña constitutes unlawful State aid forbidden by Art. 107 TFEU so it is very likely that a preliminary ruling will be raised with the CJEU in the coming months.

-- Antonio Puentes and Roberta Poza, PwC Spain; antonio.puentes@es.pwc.com

United Kingdom – European Commission opens formal State aid investigation into financing income exemption within the UK's CFC regime

On 26 October 2017, the European Commission announced in a press release that it has opened an investigation into an exemption within the UK's Controlled Foreign Company

(CFC) regime. The UK CFC rules are provisions which broadly allow the UK to tax the income of overseas subsidiaries controlled by a UK corporate parent where that income is regarded as artificially diverted from the UK.

The exemption in question was introduced as part of the 2012 revision of the UK CFC rules and means that a business with offshore financing arrangements may, in certain circumstances, be subject to a reduced CFC charge in respect of the finance income (reduced by between 75% and 100%). It has been applied by a large number of UK multinational companies and foreign companies investing into the UK.

The Commission considers at this stage that this tax treatment results in tax benefits which are not available to other comparable taxpayers because it allows the group to provide financing to a foreign company via an offshore subsidiary and suffer a reduced level of tax on the profits from these transactions. The press release highlights the Commission's concern that the exemption may not be consistent with the overall objective of the UK CFC rules.

The decision has not yet been published but will represent the preliminary assessment of the Commission in this matter.

-- Jonathan Hare and Juliet Trent, PwC UK; jonathan.hare@pwc.com

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PwC EUDTG - KEY CONTACTS:

EUDTG Chair
Stef van Weeghel
stef.van.weeghel@pwc.com

Co-chair State Aid Working Group
Emmanuel Raingeard de la Blétière
emmanuel.raingeard@pwcavocats.com

Co-chair State Aid Working Group
Chair CCCTB Working Group
Jonathan Hare
jonathan.hare@pwc.com

EUDTG Network Driver,
EU Public Affairs-Brussels (TAX)
Bob van der Made
bob.vandermade@pwc.com

Chair EU Law Technical Committee
Jürgen Lüdicke
juergen.luedicke@pwc.com

Chair FS-EUDTG Working Group
Patrice Delacroix
patrice.delacroix@pwc.com

Chair Real Estate-EUDTG WG
Jeroen Elink Schuurman
jeroen.elink.schuurman@pwc.com

EUDTG COUNTRY LEADERS:

Austria	Richard Jerabek	richard.jerabek@pwc.com
Belgium	Patrice Delacroix	patrice.delacroix@pwc.com
Bulgaria	Orlin Hadjiiski	orlin.hadjiiski@bg.pwc.com
Croatia	Lana Brlek	lana.brlek@hr.pwc.com
Cyprus	Marios Andreou	marios.andreou@cy.pwc.com
Czech Rep.	Peter Chrenko	peter.chrenko@cz.pwc.com
Denmark	Soren Jesper Hansen	sjh@dk.pwc.com
Estonia	Iren Lipre	iren.lipre@ee.pwc.com
Finland	Jarno Laaksonen	jarno.laaksonen@fi.pwc.com
France	Emmanuel Raingeard	emmanuel.raingeard@pwcavocats.com
Germany	Arne Schnitger	arne.schnitger@pwc.com
Gibraltar	Edgar Lavarello	edgar.c.lavarello@gi.pwc.com
Greece	Vassilios Vizas	vassilios.vizas@gr.pwc.com
Hungary	Gergely Júhasz	gergely.juhasz@hu.pwc.com
Iceland	Fridgeir Sigurdsson	fridgeir.sigurdsson@is.pwc.com
Ireland	Denis Harrington	denis.harrington@ie.pwc.com
Italy	Claudio Valz	claudio.valz@it.pwc.com
Latvia	Zlata Elksnina	zlata.elksnina@lv.pwc.com
Lithuania	Nerijus Nedzinskas	nerijus.nedzinskas@lt.pwc.com
Luxembourg	Alina Macovei	alina.macovei@lu.pwc.com
Malta	Edward Attard	edward.attard@mt.pwc.com
Netherlands	Hein Vermeulen	hein.vermeulen@pwc.com
Norway	Steinar Hareide	steinar.hareide@no.pwc.com
Poland	Agata Oktawiec	agata.oktawiec@pl.pwc.com
Portugal	Leendert Verschoor	leendert.verschoor@pt.pwc.com
Romania	Mihaela Mitroi	mihaela.mitroi@ro.pwc.com
Slovakia	Todd Bradshaw	todd.bradshaw@sk.pwc.com
Slovenia	Lana Brlek	lana.brlek@hr.pwc.com
Spain	Carlos Concha	carlos.concha.carballido@es.pwc.com
Sweden	Elisabeth Bergmann	elisabeth.bergmann@pwc.com
Switzerland	Armin Marti	armin.marti@ch.pwc.com
UK	Jonathan Hare	jonathan.hare@pwc.com

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.

Find out more on: **www.pwc.com/eudtg** or contact the EUDTG's Network Driver Bob van der Made (+31 6 130 96 296, or: bob.vandermade@pwc.com) or contact any of the EUDTG country contacts listed on the previous page.