EU Tax News – November/December 2021

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CONTENTS

CJEU Developments

Germany	CJEU Judgment on inheritance tax rules for non-resident taxpayers
Germany	CJEU Referral on 10% inheritance tax exemption for real property rented out for residential purposes

National Developments

Belgium	Belgian tax consolidation and potential violation of the Parent-Subsidiary Directive
Belgium	Supreme Court rules on notional interest deduction (NID) and EU general principles
Spain	The Spanish minimum 15% CIT rate
Sweden	Supreme Administrative Court decides interest deductibility rules on related party debt introduced in 2019 are not compatible with freedom of establishment

EU Developments

EU	European Commission publishes major new tax package
EU	EU public country-by-country reporting Directive enters into effect
EU	European Commission official confirms EU digital levy has been 'scrapped for good'
EU	Outcomes of the December 2021 ECOFIN Council
EU	European Commission's December direct tax infringements package involving Belgium, Luxembourg, Spain and Sweden

CJEU Developments

Germany – CJEU Judgment on inheritance tax rules for non-resident taxpayers

On 21 December 2021, the CJEU rendered its decision on the compatibility of two German inheritance tax rules with the free movement of capital (Art. 63 TFEU) in *XY vs. Finanzamt V* (*C-394/20*), The decision largely follows the AG's Opinion (see *EU Tax News – September-October 2021, Issue 2021, nr. 6*)

In the case at hand case, the plaintiff was an Austrian resident who had inherited real property situated in Germany from her father in 2018. The German assets accounted for 43% of the total value of the estate.

The plaintiff was the only person appointed as the heir in the will. Yet, other relatives were entitled to a compulsory share of the estate under Austrian inheritance law. Therefore, the plaintiff had to compensate them in money.

Under German inheritance tax law, the plaintiff was liable to tax to the extent that the inherited assets were located in Germany (limited tax liability), whilst a German resident would have been liable to tax in respect of the entire estate irrespective of the assets' location (unlimited tax liability).

Pursuant to Section 16 paragraph 2 of the German Inheritance Tax Act (ITA), the plaintiff was entitled to a tax-free allowance of EUR 172,000, which is 43% of the allowance available to a taxpayer in a case of unlimited tax liability (EUR 400,000) and thus corresponds to the fraction of the assets' value that was subject to tax in Germany.

Pursuant to Section 10 paragraph 6 ITA, liabilities linked to the inheritance are in case of limited tax liability only deductible if they are "economically linked to the taxable assets". The German tax authorities denied the deduction of the liabilities that the plaintiff owed to her relatives.

The CJEU held that the reduced allowance (Section 16 paragraph 2 ITA) does not infringe the free movement of capital. The German tax system is coherent in not granting the full allowance as only the assets located in Germany are subjected to German taxation.

However, the non-deductibility of the liabilities owed to the relatives (Section 10 paragraph 6 ITA) is not coherent as the liabilities are partly caused by the German assets. Germany must, therefore, treat at least part of the liabilities as deductible.

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Germany – CJEU Referral on 10% inheritance tax exemption for real property rented out for residential purposes

By decision 7 K 1333/19 of 2 September 2021 (published in November 2021), the Fiscal Court of Cologne referred the question to the CJEU whether it is compatible with the free movement of capital (Art. 63 TFEU) that Germany limits the application of a provision for a 10% tax exemption included in its inheritance and gift tax law to real property located in a Member State of the EU or the EEA.

Pursuant to Section 13d of the German Inheritance and Gift Tax Act (ITA) real property is assessed at only 90% of its value for inheritance tax purposes if the property in question is developed land that: (1) is rented out by the owner for residential purposes, (2) is located in a Member State of the EU or the EEA and (3) is not a business asset taxed preferentially pursuant to Section 13a ITA.

The purpose of the law is to create a (small) tax benefit for landlords renting out their private property in order to compensate them for not enjoying the same tax benefits as those enjoyed by the owners of commercial rental companies.

In the case that is pending before the Fiscal Court of Cologne the plaintiff is a German resident who in 2016 became the owner of developed land in Canada as his father's legatee. The plaintiff claims to be entitled to the tax benefit under Section 13d ITA (which was Section 13c ITA in the year under dispute).

The only requirement of the law which could possibly exclude the plaintiff from the tax benefit is the requirement that the property be in a Member State of the EU or the EEA, which is not fulfilled in the case of Canada.

According to the Fiscal Court of Cologne it is questionable whether Germany can restrict the tax benefit to EU and EEA situations given that the free movement of capital also applies to third countries. The court has therefore referred the matter to the CJEU.

The CJEU's case number is *C-670/21* (*BA*).

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National Developments

Belgium – Belgian tax consolidation and potential violation of the Parent-Subsidiary Directive

Under the current intra-group transfer regime, companies with an operational loss, but a taxable profit as a result of dividend income (from an EU subsidiary), cannot fully apply the group contribution. In the framework of the draft law regarding various tax measures, it was initially proposed that the current-year dividends received deduction could be offset with the group contribution received. Subsequently, the Belgian government considered that the current system was aligned with EU law and removed the adjustment from the draft law.

The draft law regarding various tax provisions was adopted by the Belgian Parliament on 10 January 2022, without resolving the potential violation of the EU's Parent-Subsidiary Directive.

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Belgium – Supreme Court rules on notional interest deduction (NID) and EU general principles

For years, the Belgian tax authorities have been focused on intra-group financing entities established in Belgium by multinational groups, that are applying the Belgian notional interest deduction-regime (NID) put in place in 2005 as an alternative to the special tax regime for coordination centres that had been qualified as State aid by the European Commission.

In a number of cases, the Belgian tax authorities have challenged the NID applied by the Belgian company on the basis of specific anti-abuse rules (SAAR), disallowing a set-off of income derived from "abnormal or gratuitous advantages" received from a group company against specific tax attributes, including amongst which the NID. The tax authorities argued that the Belgian company had been artificially interposed with the sole purpose to benefit from the NID tax regime. With respect to the application of a SAAR regarding the Belgian NID regime, the Belgian Supreme Court had ruled principally that any interpretation of the SAAR should consider the broader economic context.

In two similar cases, the Court of Ghent had ruled, in its judgments of 16 June 2020 and 22 December 2020, in favour of the taxpayer, considering that there was no abuse due to the presence of other (economic/business) drivers warranting the interposition of the Belgian company. The arguments of the tax authorities (among other things) that the Belgian company managed only one loan and immediately transferred the income were set aside as the intervention in the financing of an acquisition could be substantiated on the basis of economic objectives and the interest was not received in abnormal circumstances (as the group was already present in Belgium with financing activities and had the necessary knowhow and personnel; the interest payment and other conditions were at arm's length; etc.).

The Belgian tax authorities were however still not willing to accept this and brought yet another case before the Belgian Supreme Court where they invoked for the first time the argument that the applied domestic specific anti-abuse rule should be interpreted in the light of the general principle of EU law prohibiting the abuse of rights in the area of taxation. They argued that based on the primacy of international law, the EU-principle of the prohibition of tax abuse also applies in the context of a national provision designed to curb tax abuse.

In its decision of 25 November 2021, the Belgian Supreme Court ruled that the general principle of prohibition of tax abuse developed in the case law of the CJEU only applies when a taxpayer abuses a provision of EU law in order to obtain an advantage of EU law. This general principle also applies, according to the Supreme Court, when a question arises as to whether a national anti-abuse provision respects the fundamental EU freedoms.

Furthermore, the Supreme Court stipulated that, contrary to what the Belgian tax authorities had alleged, the CJEU does not recognise a general principle of EU law prohibiting tax abuse which is applicable in both an EU law and a purely domestic law context. In this respect, the Advocate-General of the Supreme Court was of the opinion that it is not required to interpret the domestic provision in the light of the general EU principle of abuse when EU law is not applied, referring to the case *3M Ita*lia (*C-417/10*).

The Supreme Court also referred to the general anti-abuse rule (GAAR) in Art. 6 of the Directive (EU) 2016/1164 of 12 July 2016 (Anti-Tax Avoidance Directive (ATAD)), which is not applicable to the arrangement in the case at hand (the set up was in 2010 and the dispute related to the 2015 assessment year, i.e., before the 1 January 2019 entry into force date of the ATAD GAAR).

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Spain - The Spanish minimum 15% CIT rate

The 2022 Budget Law introduces a minimum 15% domestic tax rate (◦ 18% minimum rate for financial and energy companies, for which the nominal rate is 30%; ◦ 10% minimum rate for newly created entities benefiting from the reduced 15% nominal rate) applicable to large corporations (turnover over EUR 20M) or entities belonging to Spanish tax groups regardless of their level of turnover. This minimum tax applies to tax periods beginning as from 1 January 2022.

This measure implies that the tax liability for in-scope companies must be equal to at least 15% of the taxable base. In practice, the 15% minimum rate would be triggered depending on the application of certain tax credits, basically those related to R&D. However, such a minimum tax will not consider differences arising due to net operating losses (NOLs) offset or double tax reliefs.

It is worth mentioning that the domestic regulation significantly differs from the OECD Model Rules (Global anti-base erosion model rules – Pillar Two). The Spanish minimum tax rate is applicable entity by entity domestically, imposing a limit to the application of the benefits foreseen in the Spanish CIT legislation.

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Sweden – Supreme Administrative Court decides interest deductibility rules on related party debt introduced in 2019 are not compatible with freedom of establishment

Over the years, Sweden has gradually limited the corporate sector's deductibility of interest costs on related party debt. Last year, in the *Lexel* case (*C-484/19*), the CJEU considered the rules applicable during the period 2013-2018. The CJEU Judgment made it clear that it was contrary to the freedom of establishment to deny the deduction of interest costs on a loan within an EU/EEA group if the borrower and lender would have been able to tax consolidate with each other by way of group contributions (which are tax deductible for the contributor and taxable for the recipient) when the foreign lender had instead been a Swedish limited liability company (see *EU Tax News – January-February 2021, Issue 2021, nr. 2*). In March 2021, the Swedish Supreme Administrative Court granted the deduction in the Lexel case (HFD 2021 not. 10).

Sweden introduced new tax rules in 2019 which are applicable to interest costs on loans from related entities. In essence, a deduction on a loan from a related entity resident in the EEA can be denied under the 2019 rules only if the debt relationship is deemed to have been put in place "exclusively or almost exclusively in order for the group to get a substantial tax benefit". The preparatory works refers back to statements in the 2013 rules, where it was stated that a substantial tax benefit cannot arise in case of a loan between two Swedish companies which can consolidate for tax purposes (using the Swedish group contribution rules). In such a case the deduction will always be granted.

In June 2021, the European Commission sent a letter to Sweden expressing the view that also the 2019 rules in practice continue to apply only in cross-border situations and were not compatible with the freedom of establishment (see *EU Tax News – May-June 2021, Issue 2021, nr. 4*). The Swedish government responded in a letter on 29 September 2021, arguing that the rules do not imply any direct or indirect restriction on the freedom of establishment. Should there be an indirect restriction, the government assessed that the rules could be justified and are proportionate (see *EU Tax News – September-October 2021, Issue 2021, nr. 6*).

On 13 December 2021, the Supreme Administrative Court ruled in a case (HFD 2021 ref. 68) where a Swedish company had received a loan from an Irish group company. The interest income was taxable in Ireland, at the tax rate of 12.5%. The deduction would have been granted if the Irish company had been Swedish, as the companies then could have exchanged group contributions with each other. The Swedish Tax Agency was of the view that the deduction should be denied and that this was in line with EU law. The Supreme Administrative Court disagreed and concluded that the denial of a deduction would constitute an infringement of the freedom of establishment. This could not be justified in cases where interest payments are made to companies in other EU Member States if the companies involved could have exchanged group contributions with each other, when both companies had been Swedish. The Supreme Court basically said that the CJEU's reasoning in the *Lexel* case could be applied to the new rules as well. The interest costs are therefore deductible for the applicant company.

This is an important ruling. It remains to be seen in case law whether the rules are incompatible with EU law also in other situations, and it will be interesting to see how the Swedish government responds to this development.

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

EU Developments

EU – European Commission publishes major new tax package

On 22 December 2021, the European Commission published another major tax package consisting of:

- A proposed EU Directive proposing implementation of the OECD/Inclusive Framework Pillar Two 15% minimum effective tax rate in the EU.
- A proposed EU Directive on measures to prevent the misuse of shell entities for tax purposes.
- Proposals for three new EU Own Resource facilities (Carbon Border Adjustment Mechanism (CBAM), Emissions Trading Scheme (ETS) and the OECD/Inclusive Framework Pillar One).

See PwC's Tax Policy Newsalerts for a deeper analysis of:

- the draft Directive proposing implementation of OECD/IF Pillar Two 15% minimum effective tax rate in the EU;
- the draft Directive to prevent the misuse of shell entities for tax purposes

The European Commission's proposals for the three new EU Own Resources to help repay the EU's COVID recovery debt package of EUR 750 bn centrally from the EU's Multiannual Budget during the period 2023-2030, comprise:

- 75% of the revenues generated by the EU's CBAM: estimated to yield around EUR 0.5 bn annually;
- 25% of the revenues generated by the EU's ETS: estimated to yield around EUR 9 bn annually; and
- 15% of the share of the residual profits reallocated to EU Member States of the largest and most profitable multinational enterprises, as per the OECD/Inclusive Framework Pillar One agreement, estimated to yield EUR 2.5-4 bn annually.

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EU – EU public country-by-country reporting Directive enters into effect

On 21 December 2021, the EU public country-by-country reporting Directive (Directive (EU) 2021/2101 of the European Parliament and of the Council of 24 November 2021 amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches), came into effect following its formal publication in the EU's Official Journal on 1 December. Click here for the text of the Directive.

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EU – European Commission official confirms EU digital levy has been 'scrapped for good'

On 15 December 2021, it was reported by Law360 that a senior European Commission official had confirmed to them that the proposed digital levy, which was intended to contribute to the EU's Multiannual Budget but which had been suspended, was due to be removed permanently from the EU's legislative agenda.

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EU – Outcomes of the December 2021 ECOFIN Council

On 7 December 2021, the ECOFIN Council adopted without further discussion its 6-monthly ECOFIN Council Report to the European Council on tax issues:

A. Initiatives in the area of EU tax law
a) Tax challenges arising from the digitalisation of the economy
b) Future initiatives in the area of corporate taxation
c) Value Added Tax (VAT)
d) Excise duties
e) Financial Transaction Tax (FTT)

B. Administrative cooperation
a) International administrative cooperation on tax matters – policy considerations
b) Administrative cooperation with non-EU countries in the area of VAT

C. Tax policy coordination (outside of the scope of EU legislation in the tax area)
a) Code of Conduct Group (Business Taxation): Council Conclusions.
NB: EU-27 Finance Ministers failed to reach an agreement on the proposed reform of the Code Group due to objections raised by Estonia and Hungary
b) International developments

***Fit for 55* Package**
Finance Ministers also took note without further discussions of the Slovenian EU Council Presidency's report on the progress reached with the Fit for 55 proposals, with particular attention to the proposals for a Carbon Border Adjustment Mechanism (CBAM) and a review of the EU Energy Taxation Directive.

Click here for the full overview of ECOFIN Council results.

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EU – European Commission's December direct tax infringements package involving Belgium, Luxembourg, Spain and Sweden

European Commission's press release:

"The Commission has decided to open infringement proceedings against **Spain**, requesting it to align its rules on the taxation of capital gains obtained within the country by non-resident taxpayers with the free movement of capital (Article 63 TFEU). In the case of capital gains, which result from a transfer of assets when the payment is deferred longer than a year or is paid in instalments in a period longer than a year, resident taxpayers have the option to pay the tax when the capital gains accrue or to defer it and pay it proportionally based on the cash flow. However, non-resident taxpayers are not offered this option of deferral and have to pay the tax when the capital gains accrue at the time of the transfer of the assets. Spain has two months to reply to the arguments raised by the Commission after which the Commission may decide to send a reasoned opinion."

"The Commission has decided to send a reasoned opinion to **Luxembourg** on the grounds of incorrect transposition of the Anti-Tax Avoidance Directive (Council Directive (EU) 2016/1164). Article 4(7) of the Directive provides for a derogation of the measures limiting the deductibility in the corporate tax base of interest payments in favour of financial undertakings. The Directive includes an exhaustive list of entities considered as financial undertakings for this purpose in its Article 2(5). However, Luxembourg grants the derogation also to securitization entities, which are not financial undertakings within the meaning of the aforementioned provision. Luxembourg has two months to respond after which the Commission may decide to refer the case to the Court of Justice of the European Union."

"The Commission has decided to send a reasoned opinion to **Sweden** regarding its legislation on taxation of dividends paid to public pension institutions. Whereas Swedish public pension funds are, as state agencies, entirely exempt from tax liability, dividends paid to comparable non-resident public pension institutions are subject to a withholding tax, commonly at a rate of 15%, as resulting from the tax treaties concluded between Sweden and other EU/EEA countries. The Commission deems that such a fiscal scheme under which dividends paid to foreign public pension institutions are subject to less favourable treatment than similar distributions in purely domestic situations infringes the free movement of capital (Article 63(1) TFEU and Article 40 of the EEA Agreement). Sweden has two months to respond after which the Commission may decide to refer the case to the Court of Justice of the European Union."

The European Commission also sent a reasoned opinion to **Belgium** on the grounds of incorrect transposition of the controlled foreign company (CFC) rules of the Anti-Tax Avoidance Directive (ATAD). Contrary to Article 8(7) of the ATAD, Belgian law does not allow a taxpayer to deduct from its tax liability the tax paid by a controlled foreign company in the state of tax residence. If Belgium does not act within two months, the European Commission may decide to refer the case to the CJEU. The application of Belgian CFC rules could lead to undesired double or even multiple taxation. For clients subject to the CFC rules, the action of the European Commission could offer a direct opportunity to claim a tax credit.

For more information on the EU infringement procedure, see for the European Commission's Q&A.
The European Commission also keeps an infringement decisions' register.

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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/EEA presence understand the impact.

See for more info: www.pwc.com/eudtg or contact bob.vandermade@pwc.com