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EU Tax News

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As the Belgian sourced income is too low, the Belgian resident loses a large part of the Belgian tax-free amount of that income and of his other personal tax advantages (such as a tax reduction for long-term savings, that is to say, premiums paid under an individual life insurance contract, and a tax reduction for costs incurred in energy savings). The Belgian resident would like to deduct these tax reductions after the application of the reduction of the exempted foreign income.

-- Patrice Delacroix, PwC Belgium; patrice.delacroix@pwc.com

Belgium – CJEU referral regarding deduction of alimony payments for non-residents

As stated in a press release on 30 October 2020, the European Commission has decided to refer Belgium to the CJEU regarding its legislation on the deductibility of alimony payments from the taxable income of non-resident taxpayers.

According to current Belgian legislation, alimony payments cannot be deducted from the taxable income of non-resident taxpayers who earn less than 75% of their worldwide income in Belgium. Belgium refuses the deduction if the 75% condition is not met, even when the taxpayer has no significant taxable income in his State of residence, which makes it impossible to deduct alimony payments from taxable income in the State of residence.

Because of this refusal, the alimony payments are deducted neither from their taxable income in their State of residence nor in Belgium (State of employment). The European Commission states it penalises non-resident taxpayers of Belgium, who have exercised their right of freedom of movement for workers. Therefore, according to the European Commission, this Belgian tax legislation constitutes an infringement of EU Law and is contrary to Article 45 TFEU and Article 28 of the EEA Agreement.

-- Patrice Delacroix, PwC Belgium; patrice.delacroix@pwc.com

Germany – CJEU referral regarding the compatibility of limited tax liability rules in the German inheritance tax act with the free movement of capital

By decision of 20 July 2020 (case no. 4 K 1095/20 Erb), the Fiscal Court of Düsseldorf requested the CJEU's opinion on two German Inheritance Tax provisions limiting tax benefits if not all the entire estate is subject to German taxation.

The plaintiff is an Austrian national and resident. In 2018, she inherited four premises located in Düsseldorf, Germany, from her father, who was also an Austrian national and resident. Under Austrian inheritance law, the plaintiff's mother and brother, whom the father had not designated to become his heirs in his last will, were entitled to a compensation payment from her (the so-called "compulsory portion of the estate").

In this case of limited tax liability, where only the assets located in Germany are subject to German Inheritance Tax, the compensation is not deductible for German Inheritance Tax purposes. Tax deductibility would require the liabilities to be "economically linked" to the taxable assets (section 10 paragraph 6 Inheritance Tax Act) which compensation payments are not, as the German Federal Fiscal Court decided on 22 July 2015 in case II R 12/14. Moreover, the plaintiff is not entitled to the full personal allowance of EUR 400,000 which applies in cases where a child inherits from his/her parent and the entire estate is taxable in Germany. Instead, the allowance is reduced in proportion to the value of the assets that are not taxable in Germany (section 16 paragraph 2 Inheritance Tax Act).

The Fiscal Court of Düsseldorf raised doubts as to the conformity of the non-deductibility of the compensation payments with the free movement of capital in light of the CJEU's decisions in the *Barbier* (C-364/01), *Eckelkamp* (C-11/07) and *Arens-Sikken* (C-43/07) cases. In addition, the Court regards the CJEU's ruling necessary (in the sense of Article 267 TFEU) as to whether section 16 paragraph 2 Inheritance Tax Act is a correct transposition of the CJEU's Judgments in *Welte* (C-181/12), Commission vs. Germany (C-211/13) and *Hünnebeck* (C-479/14). It therefore requested a preliminary ruling from the CJEU by judgment of 20 July 2020. The CJEU case no. is C-394/20 (*Finanzamt V*).

-- Arne Schnitger and Björn Bodewaldt, PwC Germany; bjoern.bodewaldt@pwc.com

Germany – CJEU referral regarding the deductibility of final losses from a foreign permanent establishment

In a decision dated 6 November 2019 (I R 32/18, published in October 2020), the German Federal Fiscal Court seeks clarification from the CJEU in respect of several questions on the deductibility of "final losses" from a foreign permanent establishment (PE). The referral is registered with the CJEU under case no. C-538/20 (*W*).

The plaintiff is a German resident bank. From August 2004 until February 2007, it operated a PE in the United Kingdom (UK). The UK PE incurred losses in all three fiscal yearsduring which it existed. After the bank had closed the UK PE in early 2007, it claimed deduction of the UK PE losses from the profits of its German head office for the purposes of German corporate tax and trade tax. The company made the case that Germany had to accept the losses as final losses under EU law, although Germany exempts profits from a UK PE pursuant to Article XVIII(2)(a) of the 1964/1970 Germany-UK tax treaty, which according to the German Federal Fiscal Court's constant jurisprudence means that losses from a UK PE are also exempt.

On 6 November 2019, the German Federal Fiscal Court referred the case to the CJEU and posed the following preliminary questions, which can have a significant impact on the question whether final losses need to be considered and may affect cases in many EU Member States:

1. Does a company's residence State infringe the freedom of establishment if it excludes final losses of a foreign PE from deduction, although a tax treaty with the PE State provides for the non-deductibility of PE losses?

2. Does the freedom of establishment prohibit such provisions as the German trade tax rules pursuant to which final foreign PE losses cannot be deducted from domestic trade profits?

3. Does the shutdown of a foreign PE lead to deductible final losses although the taxpayer could potentially open another PE in the same Member State and subsequently use the losses incurred by the first PE?

4. If the PE State provides for a carry-forward of PE losses, can losses that were at least carried forward to another fiscal year still be considered to be final losses?

5. Is the deduction of final losses limited to the amount of losses which the taxpayer would have been able to carry-forward in the PE State (according to said State's rules) or does the State of residence have to deduct the full amount of final losses computed according to its own rules?

-- Arne Schnitger and Björn Bodewaldt, PwC Germany; bjoern.bodewaldt@pwc.com

Germany – CJEU referral regarding the compatibility with the free movement of capital of the former special real estate investment fund regime

On 18 December 2019, the German Federal Fiscal Court referred to the CJEU a case (no. I R 33/17) involving a Luxembourg special investment fund with notable investments in German real estate. The referring court raised the question whether Germany's tax regime of such funds, which was in force until 31 December 2017, was in line with the free movement of capital.

The plaintiff is a Luxembourg FCP (fonds commun de placement) with the features of a special investment fund (fonds d'investissement spécialisé) as regulated in the Luxembourg law on special investment funds of 13 February 2007. The FCP only has two (institutional) investors whose seat and place of management are outside Germany. In the years in dispute (2008-2010), the FCP received income from renting and selling German real estate.

From a German perspective, the FCP is a corporate taxpayer and had to file annual corporate tax returns in the years subject to litigation. It was liable to German corporate tax on its German rental income and capital gains (limited tax liability). In contrast, the investors were not liable to German tax. Had the FCP been a comparable German special investment fund with two foreign institutional investors, it would have been tax exempt from German corporate tax pursuant to section 11 paragraph 1 of the 2004 Investment Tax Act. However, it would have been obliged to withhold taxes on behalf of its investors when receiving rental income or capital gains. Thus, in the case of a domestic special investment fund, German taxation would have occurred at the level of the investors. But technically the fund itself world have collected the tax – irrespective of whether it passed any money on to the investors or not.

In its referral decision of 18 December 2019 (published in October 2020), the German Federal Fiscal Court asks the CJEU whether the free movement of capital precludes legislation of an EU Member State under which domestic special-purpose real-estate funds with exclusively foreign investors are exempt from corporate tax, whereas foreign special-purpose real-estate funds with exclusively foreign investors are subject to limited corporate tax liability in respect of their German rental income and capital gains.

The CJEU's case no. is C-537/20 (*L Fund*).

-- Arne Schnitger and Björn Bodewaldt, PwC Germany; bjoern.bodewaldt@pwc.com

Germany – CJEU referral regarding the requirement for refunds of dividend withholding tax suffered by EU/EEA shareholders

On 20 October 2011, the CJEU ruled that Germany infringed the free movement of capital by treating domestic dividends as tax exempt at the level of domestic corporate recipients whilst EU/EEA recipients of German dividends suffered a withholding tax of 26.375% which could only be reduced pursuant to a tax treaty or the rules of the EU's Parent Subsidiary Directive (PSD) (C-284/09).

Since foreign corporate taxpayers which do not hold at least 10% of the shares in the distributing German company are not eligible for a withholding tax reduction under the PSD and can normally only claim a withholding tax reduction to 15% under the applicable tax treaty, such taxpayers were at a disadvantage in comparison with German corporate taxpayers.

Germany's reaction to the CJEU Judgment was twofold. On the one hand, the tax exemption of dividends at the level of domestic corporate taxpayers was abolished for shareholdings below 10% as of 1 March 2013. On the other hand, EU/EEA corporate taxpayers which received a German dividend before 1 March 2013, but were not able to reduce the withholding tax to 0% due to a shareholding below 10%, were given a new possibility to claim a refund of their withholding tax pursuant to section 32 paragraph 5 of the German Corporate Tax Act. However, the new refund claim requires the foreign EU/EEA applicant to prove, inter alia, that the German withholding tax paid was neither creditable nor deductible for itself or its direct or indirect shareholders in their respective residence States.

The Fiscal Court of Cologne believes that this requirement is impossible to meet for foreign EU/EEA applicants, in particular, if they have multiple shareholders. Hence, it referred the question whether the requirement is in line with the free movement of capital to the CJEU by judgment of 20 May 2020 (case 2 K 283/16). The Fiscal Court's decision is not yet publicly available.

-- Arne Schnitger and Björn Bodewaldt, PwC Germany; bjoern.bodewaldt@pwc.com

CJEU Judgment on cross-border exchange of information upon request

Further to the Berlioz Investment Fund case (C-682/15), the CJEU continues to review the legal framework of the exchange of information between EU Member States for tax purposes. Ruling on questions referred by the Luxembourg Administrative Court (C-245/19 and C-256/19), the Judgment rendered by the CJEU on 6 October 2020:

- confirms that the addressee of an information order issued in the context of an exchange between tax authorities of Member States pursuant to Directive 2011/16 is entitled to judicial review of the legality of that decision;
- concludes however that a similar legal remedy is not available to the taxpayer concerned by such an information order and to third parties.

The CJEU also included some comments on the question of foreseeable relevance of the requested information.

The Spanish tax authorities sent requests for information to the Luxembourg tax authorities pursuant to Directive 2011/16 on Administrative Cooperation (the "Directive") regarding Spanish resident individuals subject to an investigation in Spain. Following these requests, the Luxembourg tax administration adopted decisions requesting a Luxembourg company and a Luxembourg bank to provide certain information that was considered related to the Spanish individuals and the investigation.

In their decisions, the Luxembourg courts, in first instance, partially cancelled the tax authorities' requests on the grounds of the Charter of Fundamental Rights of the European Union (the "Charter") as:

- those decisions did not offer the possibility of any appeal to their recipients and
- as certain information requested was not considered as sufficiently foreseeably relevant for the tax issue being reviewed by the Spanish tax authorities.

Upon the appeal of the Luxembourg tax authorities, the Administrative Court of Luxembourg referred those two points to the CJEU for a preliminary ruling.

The CJEU ruled that the right to claim an effective remedy together with the rights to a private life which are guaranteed by the Charter:

- preclude the legislation of a Member State implementing the procedure for the exchange of information established by the Directive, to lead to the issuance of a decision by the competent authority of that Member State which would require that a person holding information would be obliged to provide such information, without offering the possibility for this person to claim a legal remedy such as judicial review of such a decision; but

- do not preclude the legislation of a Member State excluding the possibility to claim a legal remedy in respect of such type of decision by the taxpayer concerned by the investigation or by third parties concerned by the information requested.

In addition, the CJEU considers that requesting information from a third party holding such data does not constitute non- foreseeably relevant information to the extent the request indicates:

- the identity of the person holding the information in question,
- the identity of the taxpayer who is the subject of the investigation that gave rise to the request for exchange of information;
- the period covered by the investigation; and that the requests relate to contracts, invoicing and payments which, although not precisely identified, are delineated by means of criteria relating to the fact that (i) they were respectively concluded or made by the person holding the information, (ii) they took place during the period covered by the investigation and, (iii) their link with the taxpayer concerned.

The CJEU Judgement has mainly an historical value in Luxembourg, as the Luxembourg legal framework has been amended further to the Berlioz Investment Fund case and now secures a legal remedy for the addressee of an information order.

It is, however, relevant for past periods and ongoing litigation, as well as being informative for the procedures of other Member States.

With respect to the foreseeable relevance criterion, the decision provides some insight on how this criterion is to be assessed.

-- Sami Douenias and Camille Bénézet, PwC Luxembourg, sami.douenias@lu. pwc.com

Romania – CJEU Judgment on the application of the fundamental freedoms to transfer pricing adjustments on permanent establishments

On 8 October 2020, in the *Impresa Pizzarotti* case (C-558/19), the CJEU confirmed that legislation that provides for transfer pricing rules allowing pricing adjustments for notional transactions carried out between a branch in an EU Member State and its head office (parent company) in another EU Member State is not necessarily incompatible with the fundamental freedoms, even if the rule does not apply in a domestic situation, i.e. when both the branch and the parent company are resident within the same EU Member State.

Impresa Pizzarotti, the Romanian branch of SC Impresa Pizzarotti & C S.p.A. ('Pizzarotti Italia'), established in Italy, granted two loans to its Italian parent company. The loans were in place between 2011 and 2014. The two loans did not carry any interest on the amounts granted. During 2016 – 2017, the audit unit of the local tax office performed an inspection and assessed a transfer pricing adjustment on the Romanian branch, which became liable to tax on the "interest revenue" for the two loans as a result of the local transfer pricing legislation requiring that branches of non-resident companies are to be treated under the separate entity approach and to perform notional transactions at market price.

Impresa Pizzarotti subsequently brought an action before the national courts in Romania on the basis that the transfer pricing adjustment was unfounded. The national courts decided to stay the proceedings and to refer to the CJEU for a preliminary ruling on the following question:

Do fundamental freedoms within the EU preclude the application of the transfer pricing legislation to transfers of money between branches in one Member State and their parent company from another Member State, when this does not apply to branches and parent companies when both are resident within the same Member State?

The CJEU ruled that the merits of the case have to be judged based on the freedom of establishment, enshrined in Article 49 TFEU, and not on the freedom of capital in Article 63 TFEU, even if it were to be accepted that the tax regime at issue in the main proceedings has restrictive effects on the free movement of capital. The legislation does provide for a difference of treatment between a cross-border situation (subject to transfer pricing rules) and a domestic situation (not subject to the said rule), leading to a restriction on the freedom of establishment.

The CJEU considered that the restriction at issue in the main proceedings is justified by the need to ensure the balanced allocation of the power to tax between EU Member States, which constitutes an overriding reason in the public interest.

The CJEU also assessed whether the legislation at issue does not go beyond what is necessary to attain the objective pursued. As the legislation allows tax-payers, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for the transaction and as it appears (subject to verification by the domestic court) only the part exceeding what would have been agreed under fully competitive conditions is subject to a reassessment, the restriction is proportionate to the goal pursued and therefore compatible with EU law.

The CJEU Judgment confirms the approach already taken by the CJEU in the *SGI* (C-311/08) and *Hornbach-Baumarkt* (C-382/16) cases and confirms that, subject to the proportionality assessment, transfer pricing rules are not necessarily incompatible with EU law.

-- Georgiana Gheorghe and Andreea Mitirita, PwC Romania; andreea.mitirita@pwc.com

National Developments

Cyprus – Unilateral tax measures in 2021 Cyprus draft budget aim to fight aggressive tax planning

On 22 October 2020, the Cyprus Council of Ministers approved the Cyprus draft budgetary plan for 2021 (the "draft budget"). The draft budget reiterates Cyprus' commitment and willingness to continue cooperation in all appropriate fora for taxation, in full respect of the respective competencies under the EU Treaties and in light of the relevant voting procedures that are applicable for such matters. In this respect, Cyprus announced two unilateral tax measures to address aggressive tax planning:

1) Introduction of withholding tax on dividend, interest, and royalty payments to countries in Annex I of the EU list of non-cooperative jurisdictions for tax purposes (also referred to as the EU 'blacklist').

2) Introduction of a corporate tax residency test based on incorporation, in addition to the existing 'management and control' test.

The draft bills for introducing the above measures into the Cyprus tax law were sent to the Cyprus Attorney General office for legal vetting, after which they will be submitted to the Cyprus House of Representatives. Both of the measures above address Country Specific Recommendations made to Cyprus by the European Commission.

The introduction of withholding tax for payments to EU blacklisted jurisdictions also follows the EU Code of Conduct Group (Business Taxation) agreed guidance of November 2019, which recommends that EU Member States apply at least one additional defensive measure through legislation, and one such additional defensive measure is the "withholding tax measure". Per the Code of Conduct Group's agreed guidance, the deadline for EU member States to introduce such measures is 1 January 2021 (in certain instances extended to 1 July 2021).

Taxpayers should monitor for further clarification and developments on this matter so as to evaluate how this may affect their existing and new structures as well as their business.

-- Marios Andreou and Eftychios Eftychiou, PwC Cyprus; marios.andreou@pwc.com

Finland – Government proposal to bring its rules on the tax deductibility of group contributions in line with EU law

The European Commission has repeatedly requested Finland to bring its rules on the tax deductibility of group contributions in line with EU law. The European Commission initiated an infringement procedure against Finland in this regard in March 2019, with a letter of formal notice, and continued its efforts in May 2020, with a reasoned opinion.

Finland has now taken steps to remedy the situation, as the Finnish Government issued a government proposal (HE 185/2020 vp) which would enable a group deduction between a Finnish parent and its affiliated foreign EU/EEA resident subsidiary in case of so-called final losses, as defined by EU case law.

According to the proposal, a Finnish parent company may, as of 2021, deduct in Finland the amount of so-called final losses of its foreign EU/EEA resident subsidiary, by way of a group deduction, should the losses be deemed final in accordance with EU case law.

A group deduction of such a foreign EU/EEA resident subsidiary's final losses would however only be possible provided that certain other domestic law criteria are also met. Furthermore, group deduction would not be available for banks, insurance companies or pension institutions. The definition of final losses would correspond to the definitions set out in the CJEU Judgment *Marks & Spencer I* (C-446/03) and subsequent EU case law. The parent company would also have the burden of proof that the losses of the foreign EU/EEA resident subsidiary are in fact final within the meaning of the applicable EU case law. The deduction would take place during the financial year when the foreign EU/EEA resident subsidiary is dissolved.

The proposed changes are intended to enter into force on 1 January 2021.

-- Okko Koskenniemi and Janina Helekorpi (okko.koskenniemi@pwc.com)

Finland – New draft legislation introducing tax residency based on place of effective management

At the beginning of October 2020, the Finnish Government issued a proposal (HE 136/2020 vp) for fundamental tax changes for foreign entities managed from Finland, as of 2021.

The amendments proposed concern the Finnish Income Tax Act, the Finnish Business Income Tax Act and the Finnish Group Contribution Act. The aim is to tax foreign entities on their worldwide income if they are effectively managed from Finland.

In practice, the change requires defining the concepts of a 'foreign entity' and 'place of effective management'. The government proposal does not suggest changes to the law or legal practice regarding the concept of a foreign entity. Therefore, if a foreign entity would be seen comparable, based on a case-by-case analysis, to an entity defined in the Finnish Income Tax Act (such as a limited liability company), such would be deemed as a foreign entity within the meaning of the law.

The proposal has tried to formulate a sufficiently generic concept, in order to locate and evaluate an entity's place of effective management. The starting point of the evaluation is the location of the highest decision-making organ of an entity, but in addition other features such as the organizing and business-related circumstances of an entity may be taken into consideration in the evaluation. According to the government proposal, the evaluation is to be understood as a case-by-case assessment of an entity's circumstances. A Finnish tax resident foreign entity could give or receive group contribution, if such foreign entity is seen comparable to a Finnish limited liability company or a co-operative, and additionally fulfils the other requirements of the Finnish Group Contribution Act. Also, a transitional period would be granted for UCITS and AIF funds so that they would be subject to the provisions of the law only as of 2023.

Presuming the amended provisions take effect as proposed, the evaluation regarding the definition of the place of effective management will be a particularly interesting issue in the future. It is recommended that foreign entities, even if they are partially managed from Finland, investigate the potential impact of the proposed amendments as soon as possible, and if required, apply for a preliminary ruling on the new provisions' impacts.

-- Okko Koskenniemi and Janina Helekorpi (okko.koskenniemi@pwc.com)

Finland – Finland to apply the OECD TRACE model to dividends paid by Finnish publicly listed entities to nominee registered shares from 1 January 2021

The OECD published the TRACE Implementation Package (TRACE IP) for the adoption of the Authorized Intermediary system in January 2013. The TRACE initiative developed, i.e. a standardized Authorized Intermediary system for claiming tax treaty relief at source on withholding tax for portfolio investments. This has been developed with the intention of removing the administrative barriers for portfolio investors seeking treaty relief under tax treaties or a jurisdiction's domestic law.

The Finnish government proposal (HE 282/2018) amended domestic law, with regards to dividends on nominee-registered shares, and applies as of 1 January 2021. The procedure in Finland is built on three key elements: the Authorized Intermediary system, the Investor Self-Declaration (ISD) procedure and annual reporting to the Finnish Tax Authorities (TRACE XML Schema).

Register of Authorized Intermediaries

The idea is, in essence, that the Authorized Intermediary (entered into the Register of Authorized Intermediaries) closest to the nominee-registered dividend beneficiary would identify the beneficiary and pass on the information on the beneficiary's country of residence through the custody chain to the dividend payer, allowing the withholding tax to be levied in accordance with the applicable tax treaty (if any), and the correct net amount to be paid immediately to the beneficiary.

Annual reporting

The Authorized Intermediary would file beneficiary-specific annual returns (TRACE XML Schema) for tax purposes on its customer's dividends and the tax levied, to the Finnish Tax Authorities. The Authorized Intermediary's annual information return should in the future be filed every year by the end of January on dividends paid during the previous calendar year.

Investor Self Declaration (ISD)

The Authorized Intermediary will require an ISD from their investors, in order to be able to determine the tax residency of such investor. The Authorized Intermediary however has the responsibility to verify the reliability of the information given by the dividend beneficiary, based on other information it has in its possession and verify, which tax treaty (if any) is applied to the beneficiary.

Changes to applicable withholding tax rates

Most notably, a dividend withholding tax rate of 35% would be levied if no information on the beneficiary is available (compared to current 30%).

-- Okko Koskenniemi and Janina Helekorpi (okko.koskenniemi@pwc.com)

Germany – Fiscal Court of Cologne applies *Deister* case law and grants withholding tax refund plus interest to Dutch holding company based on Parent Subsidiary Directive

Germany's anti-directive-shopping and anti-treaty-shopping rule (section 50d paragraph 3 of the Income Tax Act) was held to infringe the Parent Subsidiary Directive (PSD) and the freedom of establishment in the CJEU'S *Deister and Juhler Holding* (C-504/16, C-613/16) as well as *GS* (C-440/17) Judgments. Although the named CJEU rulings have not yet led to an amendment of the German provision, the Fiscal Court of Cologne applied this case law in a judgment of 30 June 2020 (case 2 K 140/18) in order to grant a withholding tax reduction to the Dutch financial holding company of a French group.

The plaintiff is a Dutch B.V. owning 100% of the shares in a German corporate entity (GmbH). A French corporate entity (société par actions simplifiée – S.A.S.) owns 49% of the shares in the B.V. The remaining 51% belongs to a Dutch partnership whose partners are corporate entities from Germany (99.99%) and France (0.01%). All entities mentioned belong to the same French group.

In 2015 and 2016 the Dutch B.V. applied for relief from German withholding tax in respect of dividend distributions of the German GmbH. The German tax authorities only granted the relief to the extent that the French S.A.S. was a shareholder of the B.V. (49%). As regards the remaining withholding tax, the German tax authorities relied on section 50d paragraph 3 Income Tax Act which denies withholding tax relief if certain requirements are met, one of them being the non-eligibility of the applicant's shareholder to withholding tax relief. The tax authorities raised the argument that the Dutch partnership (as 51% shareholder of the B.V.) would not be entitled to benefits under the PSD which would exclude the B.V.'s withholding tax relief proportionately.

The Fiscal Court of Cologne granted the full withholding tax relief to the B.V. It underlined that pursuant to CJEU case law, the B.V. must be given the opportunity to prove that its position as shareholder of the German company is not abusive, which in the case at hand it had successfully done. The Fiscal Court also made clear that the refund is subject to annual interest of 6% which is the common interest rate for German tax claims but does not apply if the claim relates to a withholding tax refund. The taxpayer's right to interest results directly from EU law. The decision is not yet final and might be challenged before the German Federal Fiscal Court.

-- Arne Schnitger and Björn Bodewaldt, PwC Germany; bjoern.bodewaldt@pwc.com

Netherlands – Dutch dividend refund claims by non-resident investment regimes subject to condition of substitution payment

On 23 October 2020, the Dutch Supreme Court published its long-awaited response to the prejudicial questions raised by the Court of Zeeland-West Brabant in the Köln-Aktienfonds Deka ("Deka") case. This response is a continuation of the referred questions to the CJEU regarding the refund of Dutch dividend withholding tax to foreign investment funds (C-156/17; see also our EUDTG Newsalert of 31 January 2020).

The referred questions concerned the compatibility of the Dutch Fiscal Investment Institution (FII) regime (as it read until 2007) with EU law, and, more specifically, the compatibility with EU law of applying the shareholder and distribution requirements to foreign investment funds when determining their entitlement to a refund of Dutch dividend withholding tax.

The Dutch Supreme Court reconsiders its earlier judgment of 10 July 2015 in which it ruled that a non-resident investment fund is not comparable to a Dutch FII because it is not subject to Dutch dividend withholding obligation. Pursuant to the CJEU Judgement in *Fidelity Funds* (C-480/16), the Dutch Supreme Court considers that, since the Netherlands levies a dividend withholding tax on distributions both to resident and non-resident investment funds, it should ensure that non-resident investment funds are allowed access to the same systems that prevent double taxation for resident investment funds.

The Dutch Supreme Court states that not allowing the non-resident investment funds access to the refund of Dutch dividend withholding tax constitutes an obstacle to the free movement of capital which cannot be justified by compelling reasons of public interest. However, the Dutch Supreme Court considers that for the eligibility of a refund, a substitution payment is necessary; more on that below.

According to the Dutch Supreme Court, a non-resident investment fund which meets the FII-conditions can apply for a refund which is determined by taking into account a voluntary payment of Dutch dividend withholding tax on its distributions (the so-called "substitution payment"). A successful claim for a refund therefore can only be made when the condition of the substitution payment is met.

The substitution payment is based on the amount of Dutch dividend withholding tax that would have been withheld from the distributed profits if the non-resident investment fund and its shareholders would have resided in the Netherlands. Dividend taxes suffered are then deducted from this amount. If the calculation results in a negative amount, the substitution payment is set at nil. A refund is only granted to the extent that the amount of tax withheld from the dividends received by the non-resident investment fund exceeds the substitution payment.

With regard to the compatibility with EU law of the shareholder and distribution requirements, the Dutch Supreme Court states that this only becomes relevant when the non-resident investment fund agrees to the substitution payment.

A non-resident investment fund that agrees to the substitution payment must demonstrate that it meets the shareholder requirements. If this cannot be substantiated by the non-resident investment fund, it cannot be considered comparable to a Dutch FII.

With regard to the question whether the shareholder requirements lead to a de facto discriminatory treatment of non-resident investment funds, the Dutch Supreme Court finds that the listing requirement on the Amsterdam stock exchange is more burdensome for non-resident investment funds. This requirement was in force in the period 2002 – 31 July 2007, after which the regime was modified. With the entry into force of the modified regime in 2007, the Dutch Supreme Court considers that this obstacle has been removed. In the view of the Dutch Supreme Court, the modified regime applies indiscriminately and does not constitute a restriction on the free movement of capital. The Dutch Supreme Court therefore considers application of the modified regime to cases in the period 2002 – 31 July 2007 to be sufficient to remedy the discriminatory treatment.

The Dutch Supreme Court considers that the main objective of the FII regime lies in the taxation of profits of the shareholders in an investment fund. As stated by the CJEU, it follows that a resident investment fund which makes an actual distribution of its profits, and a non-resident investment fund whose profits are not distributed but are deemed to have been distributed and are taxed as such at the level of the shareholders in that fund, must be regarded as being in objectively comparable situations.

The Dutch Supreme Court considers that in such a situation a refusal to grant a refund to the non-resident investment fund would constitute a restriction on the free movement of capital which cannot be justified.

The Dutch Supreme Court further considers that the distribution requirement is met if the profit available for distribution is actually distributed to the shareholders of the investment fund within eight months after the end of the (financial) year, regardless whether there is a legal or statutory requirement to do so.

Although non-resident investment funds may be considered comparable to a Dutch FII, the introduction of the "substitution payment" as a condition that should be fulfilled in order for the funds to obtain a refund will limit the possibility of a refund claim. Where the amount of tax withheld from the dividends received by non-resident investment funds is the same or higher than the amount of the substitution payment this likely does not result in a refund. We will therefore further analyse the impact of this Dutch Supreme Court decision for pending claims.

Furthermore, we will await the final outcome of this case since the judgment of the Dutch Supreme Court was a reply on preliminary questions raised by the lower court. The lower court has to make a decision on the claims filed in accordance with the judgment of the Dutch Supreme Court.

-- Hein Vermeulen and Job Hoefnagel, PwC Netherlands; hein.vermeulen@pwc.com

Spain – Amendments to the participation exemption applicable from 1 January 2021

On 28 October 2020, the Spanish Government announced several tax measures, some of them are incorporated in the 2021 Draft Annual Budget, whilst others are included in separate legislative initiatives, which are already enacted or in the process of being approved. The Law should enter into effect on 1 January 2021, and will have no retroactive application. Hence, taxpayers have the possibility to take action before 31 December 2020. However, it cannot be discarded that it could be effectively passed before the end of the year and the government might try to apply some of the measures retroactively.

One of these important measures is the reduction of the current full participation exemption by 5%, i.e., it is expected to reduce the participation exemption on qualifying dividends and capital gains to 95%, i.e. 5% of the gross dividend and capital gain would be taxed at the standard Corporate Income Tax rate of 25%.

Another important measure is the fact of eliminating one of the alternative requirements to qualify for the participation exemption on dividends and capital gains. As per the current wording of the law, the participation exemption requires a participation of at least 5%, or an acquisition value higher than €20 million. It is expected that the alternative acquisition value requirement will be eliminated, so only participations meeting the minimum participation requirement would get access to the participation exemption.

-- Roberta Poza and Miguel Muñoz, PwC Spain; roberta.poza.cid@pwc.com

Sweden – No Swedish CFC taxation but dividends fully taxable for private persons owning shares in a Luxembourg fund company

On 7 October 2020, the Swedish Supreme Administrative Court (SAC) considered a case concerning a request for an advance ruling (case number 6446-19). Two private persons owned shares in a Luxembourg fund company of the type SA, SICAV-SIF (“the SA, SICAV-SIF”). In cooperation with a fund manager (a Luxembourg SA) and a custodian (a Luxembourg SA) the SA, SICAV-SIF had set up an alternative investment fund (AIF). In Luxembourg, the SA, SICAV-SIF was exempted from tax on its profits. Instead it was subject to an annual tax of 0.01 % of the value of the Fund Company’s net assets (taxe d'abonnement).

The private persons asked: (1) whether they would be taxed under the Swedish CFC rules for the income arising in the SA, SICAV-SIF; and, (2) if all or only five sixths of dividends received from the SA, SICAV-SIF would be taxable for them. The SAC ruled that: (1) no CFC taxation would arise; and, (2) that all dividends received would be taxable for the shareholders.

Under the Swedish CFC rules, the SA, SICAV-SIF was deemed as lowly taxed. Thus, in principle Swedish CFC taxation would arise for the two private persons. Under Swedish CFC rules and following the CJEU in *Cadbury Schweppes* (C-196/04), no CFC taxation would take place if a foreign company resident in the EU/EEA constitutes a genuine establishment from where a commercially motivated business is carried out.

The SAC found that the business in the SA, SICAV-SIF was organised and carried out in line with the AIFM Directive. The Board of Directors had sufficient resources and competence for its assignment. In such a case, the fact that the SA, SICAV-SIF lacked its own staff and that it was the Fund Manager and not persons employed by the SA, SICAV-SIF that made the decisions in the day-to-day operations was irrelevant. Hence, the SAC found that the SA, SICAV-SIF constituted a genuine establishment and that no CFC taxation should be imposed.

The second question was whether the special Swedish rules reducing the tax rate for certain dividends and capital gains for private persons were applicable. A person who is domiciled in Sweden and owns shares in Swedish or foreign companies is as a main rule taxable for dividends or capital gains on the shares. Under Swedish rules, only five sixths of dividends and capital gains on shares in unlisted Swedish companies shall, if certain conditions are fulfilled, be taxable (i.e. the tax rate is in practice reduced). The same applies to shares in unlisted foreign companies if the income taxation of the company is deemed to be comparable with the income taxation of a Swedish company. The purpose of the rules is to give relief from double taxation of the income of a company. If the condition of comparable taxation is not fulfilled, this means that the dividend and the capital gain are taxed in their entirety.

The SAC merely stated that the condition of comparable taxation was not fulfilled since the company did not pay any income tax at all in Luxembourg, but only an annual tax of 0,01% of its assets value.

The question that remained to be assessed was whether this condition (of “comparable taxation”) was contrary to EU law and therefore could not be upheld. In the court case HFD 2017 ref. 57, the SAC ruled that it would be contrary to the free movement of capital not to apply these rules to a Cyprus company which was deemed as not comparably taxed since the corporate income tax rate in Cyprus (10% at the time) was lower than the Swedish one (at the time 26.3%). Only five sixths of the dividend from Cyprus was thus taxable.

In the present case, the assessment is different. Since the relevant rules were applicable regardless of the size of the shareholding, the SAC made the assessment against both the freedom of establishment and the free movement of capital. The SAC found that there was a restriction that in principle was contrary to the two freedoms. However, the SAC concluded that the cross-border and the domestic situation were not objectively comparable. The reason for this was that the purpose of the Swedish rules is to reduce the risk of double taxation of profits. As the SA, SICAV-SIF - unlike the Cyprus company in the 2017 court case - did not pay any tax on its profits in Luxembourg, this excluded the risk of double taxation. An owner of shares in SA, SICAV-SIF was thus not in an objectively comparable situation as an owner of a Swedish limited liability company. Hence, it was not contrary to EU law to exclude dividends and capital gains on the shares in the SA, SICAV-SIF from the application of the rules of taxation of five sixths.

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

Sweden – New rules regarding non-deductibility for interest costs from 1 January 2021

The Swedish Government has proposed new rules for non-deductibility of a company's (external and internal) interest costs on debts to a company within a jurisdiction which is placed on the EU list of non-cooperative jurisdictions. The term "company" refers to legal entities and Swedish partnerships (Sw. handelsbolag). The new rules will not be limited to related companies, i.e. the non-deductibility rule will be applied in relation to all companies. The new rules will, according to the proposal, only target interest costs which have been incurred during the time that the jurisdiction was listed on the EU list. The Government wants a dynamic approach, such that any changes to the EU list have immediate effect. The wording of the proposed new rules regarding interest deduction reflects this.

The rules were scheduled for adoption by the Swedish Parliament by the end of November 2020 to allow for them to enter into force on 1 January 2021.

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

Sweden – Amended Swedish CFC rules related to Trinidad and Tobago from 1 January 2021

The Swedish Government has proposed new rules to ensure the application of the CFC rules in relation to Trinidad and Tobago (which at the time of the proposal, and currently, is listed on the EU list of non-cooperative jurisdictions). The reason for this is that Sweden has a double tax treaty with Trinidad and Tobago which can affect the application of the proposed rule for non-deductibility of interest costs in relation to this jurisdiction. The amendment means that Trinidad and Tobago are removed from the list of approved countries.

The rules were scheduled for adoption by the Swedish Parliament by the end of November 2020 to allow for them to enter into force on 1 January 2021.

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

EU Developments

Belgium – European Commission formally requests Belgium to bring its rules on exemption of income from savings deposits in line with EU law

Following the CJEU's Judgment in *Van der Weegen* of 8 June 2017 (C-580/15), the European Commission requested Belgium to amend its rules regarding the exemption of income from savings deposits. Under Belgian law, an amount of interest from savings deposits is not subject to personal income tax if the deposits satisfy certain conditions. In *Van der Weegen*, the CJEU decided that this rule is capable of constituting an impediment to the freedom to provide services, because it imposes conditions for access to the Belgian banking market on service providers established in other EU Member States. Several Belgian Courts have confirmed that certain EU savings deposits are eligible for the Belgian tax exemption. The European Commission has now asked Belgium to amend its legislation.

-- Patrice Delacroix, PwC Belgium; patrice.delacroix@pwc.com

Belgium – European Commission formally requests Belgium to bring taxation of dividends on shares held by foreign life insurance companies in Belgium in line with EU law

The European Commission has requested Belgium to stop taxing dividends on shares held by foreign life insurance companies more heavily than dividends received by Belgian insurance companies.

Previously, the European Commission had already launched an infringement procedure in this context against Finland (C-342/10) based on the free movement of capital (Article 63 TFEU). Regarding the Finnish legislation, the CJEU considered that a national legislation making dividends paid by resident companies to foreign pension funds subject to a stricter tax regime than the regime applicable to national pension funds is incompatible with the free movement of capital.

On 13 November 2019, the CJEU also ruled in College Pension Plan of British Columbia v Finanzamt München (C-641/17) that the German legislation regarding pension funds was incompatible with Article 63 TFEU. Indeed, in practice, German pension funds were exempt or practically exempt from tax, thereby putting non-resident funds at a disadvantage.

In Belgium, a similar regime exists. Under the Belgian legislation, Belgian life insurance companies are effectively exempt (or almost fully exempt) from tax on income from dividends, interest and real estate, including capital gains. In contrast, outbound dividends and interest or income paid to life insurance companies established in other EU/EEA countries are subject to withholding taxes generally ranging from 15% to 30%, and outbound income from real estate is subject to corporate tax.

The European Commission sent a letter of formal notice to Belgium in October 2020 by which it requests Belgium to comply with EU law because the higher taxation in Belgium of dividends on shares held by foreign life insurance companies is discriminatory and incompatible with the free movement of capital, Article 63 TFEU (and 40 EEA Agreement). Belgium is given two months to provide a satisfactory response, otherwise, the European Commission may decide to finally refer the case to the CJEU. Based on the well-established case law of the CJEU in this regard, we do not see how Belgium could maintain such a discrimination in its domestic legislation.

-- Patrice Delacroix, PwC Belgium; patrice.delacroix@pwc.com

EU – European Commission adopts its 2021 work programme

On 19 October 2020, the European Commission adopted its work programme for 2021, which is closely linked to the recovery plan for Europe, with the NextGenerationEU recovery instrument and a reinforced EU budget for 2021-2027. To repay the funds raised under NextGenerationEU, the European Commission announced it would forward proposals for new own resources “starting with a revised Emission Trading System, a Carbon Border Adjustment Mechanism and a 'digital levy'”.

Not mentioned in the work programme was the European Commission's Communication on Business Taxation for the 21st Century, which was expected on 28 October 2020. This EU strategy paper was delayed at the last minute by a number of months following the announced delay in reaching a global consensus in the context of the OECD/G20 Inclusive Framework for BEPS (now deadline of mid-2021). It is expected that this Communication will also include the EU's strategy on how it will implement agreements at the OECD level in the EU, as well as setting out intentions to move unilaterally (i.e. as EU-27) on digital tax if no global agreement is reached. The European Commission did present 44 new policy objectives under six headline ambitions in Annex 1 of the 2021 work programme:

The von der Leyen Commission stated that its 2021 work programme is the result of close cooperation with the European Parliament, EU Member States and the EU consultative bodies. The work programme informs the public and the co-legislators (European Parliament and Council of the EU (Member States) of the European Commission's political commitments to present new initiatives, withdraw pending proposals and review existing EU legislation. It does not cover the ongoing work of the European Commission to implement its role as Guardian of the Treaties and enforce existing legislation or the regular initiatives that it adopts every year.

The European Commission's work programme for 2021 can be found here

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

EU – European Parliament's Permanent Subcommittee on Tax Matters (FISC) starts its work

On 23 September 2020, the European Parliament's new permanent subcommittee on taxation, dubbed "FISC" held its constitutive meeting and elected its chairs and vice-chairs:

Chair: Paul Tang (S&D, NL)
1st Vice-Chair: Markus Ferber (EPP, DE)
2nd Vice-Chair: Martin Hlavaceck (Renew, CZ)
3rd Vice-Chair: Kira Peter-Hansen(Greens, DK)
4th Vice-Chair: Othmar Karas (EPP, AT)

The subcommittee on tax matters is composed of 30 members and its mandate instructs it to deal primarily with the fight against tax fraud, tax evasion and tax avoidance, as well as financial transparency for taxation purposes.

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

EU – ECOFIN Council of 6 October 2020: update of EU list of non-cooperative jurisdictions for tax purposes

The ECOFIN Council of 6 October 2020 decided to add Anguilla and Barbados to the EU list of non-cooperative jurisdictions for tax purposes. Cayman Islands and Oman were removed from the list.

The EU list of non-cooperative jurisdictions for tax purposes is part of the EU's external strategy for taxation and aims to contribute to ongoing efforts to promote tax good governance worldwide. It lists non-EU jurisdictions that according to the EU's Member States (via the Code of Conduct Group of Business Taxation), either have not engaged in a constructive dialogue with the EU on tax governance or have failed to deliver on their commitments to implement reforms to comply with a set of good governance criteria for tax transparency, fair taxation and international standards against tax base erosion and profit shifting.

Following this ECOFIN Council update, twelve jurisdictions remain on the list of non-cooperative jurisdictions ('Annex I): American Samoa, Anguilla, Barbados, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, the US Virgin Islands and Vanuatu.

As regards Annex II (list of non-EU jurisdictions which do not yet comply with all international tax standards but have provided sufficient undertakings to reform their tax policies, aka 'the grey list'), due to the ongoing COVID-19 global pandemic the Council decided to extend several deadlines for these commitments. The Council decided to remove Mongolia and Bosnia and Herzegovina from Annex II.

The EU list of non-cooperative jurisdictions for tax purposes is updated twice a year and can be found here.

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

EU – State of the (European) Union address by European Commission President von der Leyen

In her State of the Union address on 16 September 2020, President of the European Commission Ursula von der Leyen presented her vision for a Europe "that emerges stronger from the pandemic and leads the way towards a new vitality. With NextGenerationEU, Europe has a once in a lifetime opportunity to make change happen by design. It has the vision, the plan, the investment. To enable Europe to become green, digital and more resilient, the European Commission will focus on:

- Protecting lives and livelihoods in Europe, the health of our citizens and the stability of our economy;
- Reinforcing the building blocks of the European Green Deal and raising our ambitions;
- Leading the digital transformation, particularly on data, technology and infrastructure;
- Making the most of our single market;
- Continuing to rally global response as the world awaits an accessible, affordable and safe vaccine against COVID-19;
- Responding more assertively to global events and deepening our relations with EU's closest neighbours and global partners;
- Taking a new approach to migration, remaining vigilant on the rule of law and building a union where racism and discrimination have no place."

With regard to taxation, President Von der Leyen stated:

"By next summer, we will revise all of our climate and energy legislation to make it "fit for 55". We will enhance emission trading, boost renewable energy, improve energy efficiency, reform energy taxation."

She added:

"We will work for just globalisation. But we cannot take this for granted. We must insist on fairness and a level playing field. And Europe will move forward – alone or with partners that want to join. We are for example working on a Carbon Border Adjustment Mechanism. Carbon must have its price – because nature cannot pay the price anymore. This Carbon Border Adjustment Mechanism should motivate foreign producers and EU importers to reduce their carbon emissions, while ensuring that we level the playing field in a WTO compatible way.

The same principle applies to digital taxation. We will spare no effort to reach agreement in the framework of OECD and G20. But let there be no doubt: should an agreement fall short of a fair tax system that provides long-term sustainable revenues, Europe will come forward with a proposal early next year. I want Europe to be a global advocate for fairness."

Finally, she concluded;

"Our economies need continued policy support and a delicate balance will need to be struck between providing financial support and ensuring fiscal sustainability. In the longer-term there is no greater way to stability and competitiveness than through a stronger Economic and Monetary Union."

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

EU – Overview of implementation of EU list defensive measures in the tax area in EU Member States

The EU Member States have committed, as of 1 January 2021, to using the EU list of non-cooperative jurisdictions (the EU list) in the application of at least one of four specific legislative measures:

a) non-deductibility of costs incurred in a listed jurisdiction
b) controlled foreign company (CFC) rules, to limit artificial deferral of tax to offshore, low-taxed entities
c) withholding tax measures, to tackle improper exemptions or refunds
d) limitation of the participation exemption on shareholder dividends.

In view of the above deadline, PwC has prepared an overview of the defensive measures currently applicable or proposed in each EU Member State. The results at this stage include updates from 25 countries (Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Spain, Sweden and the UK). The publication reveals that the majority of EU Member States has not yet introduced a defensive measure. This is, however, expected to change soon as the deadline of 1 January 2021 approaches. In addition, certain EU Member States apply the EU list, in parallel with a domestic list, for the purposes of the application of a defensive measure.

The publication can be found here.

-- Vassilis Dafnomilis, PwC Netherlands; vassilis.dafnomilis@pwc.com

EU – Overview of the impact of the Danish beneficial ownership cases across the EU

The beneficial ownership (BO) concept has been the subject of increased attention since the CJEU ruled on the so-called "Danish beneficial ownership cases" in February 2019 (Joined Cases C-116/16 and C-117/16 and Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16). PwC has created a beneficial ownership (BO) Factsheet which includes updates and information on

i) EU Member States' legislation regarding beneficial ownership
ii) case law developments in relation to Danish beneficial ownership cases,
iii) tax authorities' focus on beneficial ownership; and
iv) other observations.

The results of the BO factsheet are based on input from 30 countries (Austria, Belgium, Bulgaria, Croatia, Czech Republic, Cyprus, Denmark, Estonia, Finland, France, Germany, Gibraltar, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Spain, Sweden, Switzerland, Slovenia and the UK), and is available here.

-- Vassilis Dafnomilis, PwC Netherlands; vassilis.dafnomilis@pwc.com

Spain – European Commission urges Spain to transpose the EU Directive on anti-avoidance practices concerning hybrid mismatches

In October 2020, the European Commission sent a reasoned opinion reminding Spain that it should have transposed the Anti-Tax Avoidance Directive concerning hybrid mismatches into national law by 31 December

2019 (Council Directive (EU) 2017/952 amending Directive (EU) 2016/1164, also known as ‘ATAD 2'). The purpose of that Directive is to ensure that multinational companies cannot artificially reduce their obligation to pay corporate tax by exploiting differences between the tax systems of Member States and those of non-EU countries (so-called 'hybrid mismatches'). If Spain does not act accordingly, the European Commission could refer the case to the CJEU and request it to impose sanctions on Spain for having failed to transpose the Directive into its national law in due time.

-- Roberta Poza and Miguel Muñoz, PwC Spain; roberta.poza.cid@pwc.com

KEY EUDTG NETWORK CONTACTS

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

Bob van der Made
EUDTG Network Driver | EU affairs
bob.vandermade@pwc.com

Emmanuel Raingeard
Chair Technical Committee | Co-Chair State Aid Working Group
emmanuel.raingeard@pwcavocats.com

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

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

Jeroen Elink-Schuurman
Chair Real Estate-EUDTG WG
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 Republic	David Borkovec	david.borkovec@pwc.com
Denmark	Soren Jesper Hansen	sjh@dk.pwc.com
Estonia	Martin Lehtis	martin.lehtis@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	Rosa Areias	rosa.areias@pwc.com
Romania	Andreea Mitirita	andreea.mitirita@pwc.com
Slovakia	Christiana Serugova	christiana.serugova@pwc.com
Slovenia	Miroslav Marchev	miroslav.marchev@pwc.com
Spain	Roberta Cid Poza	roberta.poza.cid@pwc.com
Sweden	Fredrik Ohlsson	fredrik.ohlsson@pwc.com
Switzerland	Armin Marti	armin.marti@ch.pwc.com
United Kingdom	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/EEA presence understand the impact. See for more info: www.pwc.com/eudtg or contact bob.vandermade@pwc.com