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CJEU Developments

Germany –AG Opinion on inheritance tax rules for non-resident taxpayers

On 16 September 2021, Advocate General Richard de la Tour delivered his opinion 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*).

In this case, the plaintiff is an Austrian resident who in 2018 inherited real property situated in Germany from her father. The German assets accounted for 43% of the total value of the death estate. The plaintiff was the only person who was appointed as 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 is liable to tax to the extent that the inherited assets are located in Germany (limited tax liability), whilst a German resident would be 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 is 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 is subject to tax in Germany.

Pursuant to Section 10 paragraph 6 ITA, liabilities linked to the succession are in the case of limited tax liability deductible only 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.

Before the Fiscal Court of Düsseldorf, the plaintiff claimed to be entitled to a tax-free allowance of EUR 400,000 as well as the deduction of the liabilities. The Fiscal Court asked the CJEU for a preliminary ruling.

In his Opinion, AG De la Tour proposed to the CJEU to hold that the reduced allowance does not restrict the free movement of capital whereas the non-deductibility of liabilities does constitute a restriction which cannot be justified by overriding reasons in the public interest.

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National Developments

Joint Statement by Austria, France, Italy, Spain, UK and US on a compromise on a transitional approach to existing unilateral Digital Services Tax measures until Pillar One is in effect

On 8 October 2021, Austria, France, Italy, Spain, the United Kingdom and the United States, joined 130 other members of the OECD/G20 Inclusive Framework in reaching political agreement on the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy. On 21 October 2021, they issued a Joint Statement on a compromise on a transitional approach to existing unilateral Digital Services Tax (DST) measures until Pillar One of the two-pillar solution is in effect.
In the case of Austria, France, Italy, Spain, and the UK:

Each country agrees to provide a credit ("Interim Credit") equal to the Credit Amount. The Credit Amount is the amount of excess DST liabilities accrued in the respective country in the period beginning on 1 January 2022 and ending on the earlier of the date the multilateral convention (MLC) implementing Pillar One comes into force, or

31 December 2023 (the “Interim Period”) over and above a figure for Amount A for an equivalent period (actual Amount A if it is a year or pro rata to the ‘first year’ liability if other than 12 months). The Interim Credit shall be applied in the first taxable year that a taxpayer that is part of a multinational enterprise (MNE) group is subject to Amount A tax liability under Pillar One after the Interim Period, and only against corporate income tax liability arising from the new taxing right under Pillar One. In the case of a taxpayer that is not a member of a MNE group that is subject to Amount A tax liability under Pillar One in the first taxable year in which Pillar One is in effect in the respective country, the Interim Credit shall be determined on the basis of the first year in which Pillar One applies to such taxpayer and shall become available at such time, except that Interim Credits shall not be available for a MNE group that first becomes subject to Pillar One more than four years after Pillar One comes into effect in the respective country. If, in the respective country, the Interim Credit exceeds the liability arising from the new taxing right under Pillar One in a taxable year, the excess Interim Credit amount shall be carried forward, credited against tax liability arising from the new taxing right under Pillar One, and commensurately reduced in each subsequent taxable year until the entire Credit Amount has been fully utilized.

In the case of the US:

In return, the US will terminate trade actions proposed under Section 301 and commit not to impose further trade actions with respect to the existing DSTs imposed by Austria, France, Italy, Spain, or the UK during the Interim Period, provided that the respective country follows through on the agreement described above.

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UK – Repeal of UK’s EU cross-border group relief legislation

The UK’s EU cross-border group relief legislation has been repealed with effect from 27 October 2021.

From April 2006, following the taxpayer’s partial win in CJEU Case C-446/03 *Marks & Spencer*, statutory relief was made available in the UK on a very limited basis (with very restrictive conditions) for final losses of subsidiaries or other group member companies resident in a Member State of the EU. Readers may recall that the UK legislation permits relief only where the taxpayer can show that the *Marks & Spencer* ‘no possibilities test’ (i.e., that there is no possibility of using the losses locally against profits past, present or future) is satisfied on the basis of the facts as they stood immediately after the end of the accounting period in which the loss arose. In practice that meant the EU subsidiary had to cease trading and be wound up immediately after the period of the loss. This rule was challenged by the European Commission as disproportionately restrictive, however, the challenge failed in CJEU Case C-172/13 *Commission v UK*.

The so-called ‘*Marks & Spencer* exception’ is of course an application of the freedom of establishment under Art.49 TFEU, which no longer applies to the UK following its departure from the EU. Moreover, UK regulations (the Freedom of Establishment and Free Movement of Services (EU Exit) Regulations 2019, SI 2019/1401) have repealed the application of the freedom of establishment to the UK with effect from the end of the Brexit implementation period on 31 December 2020.

The UK government has therefore taken the logical step and introduced draft legislation in the 2021 Finance Bill to repeal the UK’s cross-border group relief legislation. Relief will no longer be available for non-UK losses of an EU-resident group member arising in periods after 26 October 2021.

The Bill also tightens up the legislation relating to group relief for UK Permanent establishment (PE)/branch losses of UK PEs of non-resident companies. Following CJEU Case C-18/11 *Philips Electronics* of 6 September 2012, the UK legislation was amended for losses of a UK PE of a company resident in an EU Member State, to soften the restrictions which excluded relief where any part of the loss was allowable against non-UK profits for non-UK tax purposes. For periods after 26 October 2021, this relaxation no longer applies, and the rules for losses of UK PEs of EU-resident companies will be the same as those for losses of UK PEs of foreign companies resident in a territory outside the EU.

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EU Developments

EU – European Commission outlines its plans for implementing OECD/Inclusive Framework international tax reform agreement in the European Union

On 8 October 2021, the OECD Inclusive Framework (IF) announced that 136 out of 140 member countries agreed to a Two-Pillar Solution to address the tax challenges arising from the digitalisation of the economy. The European Commission indicated in the course of October how the OECD/IF agreement on Pillars One and Two will be implemented in the European Union.

Regarding Pillar Two, the European Commission will announce its proposal for an EU Directive implementing the OECD/IF agreement on 22 December 2021, provided that the OECD can publish sufficiently detailed plans by the end of November. The European Commission believes the proposal can be quickly agreed upon by all EU-27 Member States and subsequently enter into effect in the course of 2023.

The European Commission has indicated that it has yet to decide whether it will also propose an EU Directive for implementing Pillar One in the European Union since it may be the case that the OECD/IF agreement is directly binding on the signatory countries and that an EU Directive is therefore not required. A European Commission proposal may be expected by Q3 2022 at the earliest, as the OECD will first have to go through the process of agreeing on mutual instruments in the summer of 2022.

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EU – European Parliament adopts Resolution on harmful tax practices and reform of the EU Code of Conduct Group on Business Taxation

After a heated debate the day before, the European Parliament adopted a draft ECON Committee report on harmful tax practices and reform of the EU Code of Conduct Group (Business Taxation) on 7 October 2021. This Resolution was adopted by 506 votes in favour, 81 votes against and 99 abstentions. Some Members of the European Parliament are calling for the introduction of an EU-wide harmonised corporate tax rate, ambitious and quick reform of the Code Group and more transparency with regard to the criteria used for the EU's list of non-cooperative jurisdictions for tax purposes (EU "blacklist"), and adding EU Member States to the blacklist. What is also noteworthy is that European Commissioner Gentiloni, who is responsible for Economy including tax policy, has lamented that the reform of the Code Group is not going fast enough because a minority of EU Member States are dragging their heels.

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Sweden – Swedish government responds to European Commission on Swedish related party interest deduction limitation rules

Previously, the European Commission has questioned the Swedish rules on related party interest deduction limitation which were applicable during the period 2013-2018. Those Swedish rules have also been subject to a ruling by the CJEU in the so-called *Lexel* Case (C-484/19). The *Lexel* 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) if the foreign lender had instead been a Swedish limited liability company.

In a letter to the Swedish government in June 2021, the European Commission announced that it was of the view that also the 2019 rules in practice continue to apply in cross-border situations only. This is, according to the European Commission, not compatible with the freedom of establishment. In the letter, the European Commission asked for the government's view on this matter (see EU Tax News – May/June 2021 Issue 2021 - nr. 4).

The Swedish government responded on 29 September 2021. The government is of the view that the rules do not imply any direct or indirect restriction on the freedom of establishment. Should there be an indirect restriction, the government assesses that the rules can be justified and are proportionate. Thus, the government rejects the view of the European Commission with essentially the following arguments:

- The scope of the rules has been narrowed to include, in principle, abusive situations only. Therefore, the rules are in line with the international work against aggressive tax planning with interest deductions, which is supported by both the OECD and the EU;
- The 2013 rules were also applicable on domestic groups where the borrower and lender could not exchange group contributions with each other. Such situations are not as uncommon as the European Commission claims;
- The rules are general and apply to loans from both domestic and foreign lenders;
- The form of abuse that the rules aim to counteract differs from such forms of abuse as for example not-market interest conditions which previously has been assessed by the CJEU; and
- Hence, there is no presumption of tax avoidance which implies that a deduction is refused in intra-group situations. On the contrary, there are high requirements for denying interest deductions.

The Swedish government is correct stating that the 2019 rules have been narrowed and give more the impression to be anti-abuse rules than before. Despite that, a number of objections can in our view be raised against the statements that the government puts forward and the picture of the situation that the government is painting in the letter. It is quite evident that the rules are not as neutral as the answer from the Swedish government gives the impression of. In addition, the rules are not explicitly targeting only wholly artificial arrangements and also most likely to go too far to be deemed to be proportionate. The conclusion of this could be that the 2019 rules are not compatible with EU law either. It now remains to be seen how the European Commission will act in relation to this issue going forward.

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EU Fiscal State Aid Developments

Belgium – CJEU decides the Belgian excess profits regime constitutes an aid scheme and refers the case back to the General Court

The decision relates to the appeal lodged by the European Commission against the decision of the General Court of the European Union ("General Court") of 14 February 2019 (Cases T-131/16 *and* T-263/16), in which the General Court set aside the final State aid decision of the European Commission of 11 January 2016, finding that the European Commission had erroneously classified the Belgian excess profit ruling system as 'an aid scheme' (click here to access our previous EUDTG Newsalert).

The current dispute between the Belgian government, the impacted Belgian companies and the European Commission has been ongoing for many years. The case relates to a provision under Belgian tax law that exempted certain income, which is considered as excess profits, i.e., profits that are - on an arm's length basis - not considered to relate to the Belgian activities. The Belgian tax ruling office used to apply this provision on a case-by-case basis and deliver individual rulings confirming its correct application to the case at hand if and where appropriate (the "excess profit rulings").

In its final decision, the European Commission took the view that these rulings constitute unlawful State aid as, in the European Commission's view, the excess profit provision provided advantages that are selective (i.e., not available to all comparable companies). Furthermore, the European Commission considered that the rulings should not be assessed on a case-by-case basis to demonstrate in each case the existence of an individual aid but rather the consistent administrative practice by the Belgian tax authorities should be considered an aid scheme.

The General Court annulled the European Commission's decision, finding that the European Commission made methodological errors by considering that the excess profit rulings are an aid scheme. In other words, according to the General Court, the European Commission should have reviewed the specifics of each ruling to determine on a case-by-case basis the existence of an individual aid.

On 16 September 2021, the CJEU annulled the judgment of the General Court and, by doing so, upheld the final decision of the European Commission regarding the qualification of the Belgian excess profit provision and consistent ruling practices as an aid scheme.

This decision represents the start of another stage in a legal procedural journey. The CJEU looked into the methodological aspects of the General Court's judgment concerning the question of whether there was an aid scheme or individual aid. Having concluded that the arrangements were properly regarded as an aid scheme, the CJEU has referred the case back to the General Court to address the substantive matters in the case such as the existence of a selective advantage and the identification of the beneficiaries of the alleged aid. The final decision as to whether the Belgian excess profit rulings actually constitute unlawful State aid may still take a number of years.

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Spain – CJEU rules the Spanish Financial Goodwill amortization regime constitutes an aid scheme

On 6 October 2021, the CJEU, sitting as the Grand Chamber, delivered its judgments on several appeals (C-50 - C-53/19P, C-64/19P and C-65/19P) lodged by different beneficiaries of the regime and the Kingdom of Spain against the decisions of the General Court of the EU ("General Court") of 15 November 2018, in which the General

Court, adjudicating on a previous referral back from the CJEU, dismissed the appeals against the final State aid decision of the European Commission of 28 October 2009 and 12 January 2011 ("contested decisions") (click here to access our previous EUDTG newsalert).

The dispute between the Spanish government, the impacted companies and the European Commission has been ongoing for more than fifteen years. The disputed tax measure was introduced in 2001 into the Spanish Corporate Tax Law and allowed the deduction of the financial goodwill resulting from the acquisition by a resident undertaking of a shareholding of at least 5% in a foreign company, in the form of an amortisation, from the basis of assessment for the corporate tax for which the resident undertaking was liable, provided that relevant shareholding was held without interruption for at least one year. By the contested decisions, the European Commission declared that such tax measure constituted an aid scheme incompatible with the internal market and ordered its recovery, except in the case of beneficiaries protected by legitimate expectations (i.e. acquisitions conducted prior to 21 December 2007). The General Court annulled both contested decisions by judgments of 7 November 2014, taking the view that the European Commission had not established that the measure was selective since, being a measure of general application, the European Commission failed to identify a category of undertakings which are exclusively favoured by the measure at issue. In the appeal brought by the European Commission against those judgments, the CJEU set them aside and referred the case back to the General Court in its judgment of 21 December 2016. In the judgments delivered in the referral back, the General Court found that, considering the findings of the CJEU Judgments, the measure was selective and dismissed the actions for annulment brought against the contested decisions.

The CJEU dismissed all the appeals brought against the judgments of the General Court clarifying to some extent its complex case-law on the selectivity of tax measures, particularly in the case of measures of general application that constitute an aid scheme. In particular the CJEU confirmed that a measure can still be selective even if the transaction benefitting from the measure is open to all undertakings.

Even if the decision represents the end of the debate on the selectivity of the amortisation of financial goodwill, it does not put an end to the legal battle that surrounds this measure, since there are still pending appeals with the General Court against the third decision of 15 October 2014, issued by the European Commission in relation to the measure (i.e., application of the amortisation in the case of goodwill resulting from the acquisition of holding companies) and an important amount of recovery procedures at different national administrative or judicial stages that raise questions on the application of the legitimate expectations recognized in the contested decisions.

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