Briefing

International review for May

Speed read

This month's news illustrates the continual tension in global tax between the desire to converge with international norms, as seen in the recent Nigerian and Kenyan announcements, and the wish to protect the domestic tax base with bespoke rules like the Australian GAAR and Canadian MDR rules. The advocate general has issued an opinion in the *Engie* case which, if followed by the CJEU, could have significant implications for other Commission decisions. In a significant milestone for 'fit for 55' in the EU, the new CBAM and revised ETS have now been formally adopted. Finally, Lithuania is the latest member state to take steps to transpose the EU public country-by-country reporting rules into domestic law.

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BEPS 2.0 update

On 31 March 2023, the president of Kenya announced plans to review the country's digital service tax (DST) and to align it with the OECD two-pillar solution. This announcement represents a shift in policy for Kenya who chose not to sign the OECD Inclusive Framework (IF) statement on a two-pillar solution back in October 2021.

It will be interesting to see if these developments mark the start of a Pillar Two implementation trend in Africa, which has so far only seen South Africa and Mauritius formally indicate an intention to adopt the rules

Nigeria is another country which did not sign the 2021 IF statement, but that is now showing signs of a shift in approach. On 4 and 5 April 2023, the Nigerian Federal Inland Revenue Service (FIRS) held a workshop with a delegation from the OECD to familiarise relevant government officials with the Pillar Two rules, and to discuss the potential benefits for Nigeria. An outcome statement following the workshop advised the need to consider immediate implementation of fiscal policy measures to mitigate any detrimental impact to Nigeria from 2024, by virtue of other jurisdictions implementing the rules. It also highlights the need for Nigeria's continued participation in the rule development within the IF to ensure that the interest of the country and Africa are considered in the design and development of the rules.

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Following a public consultation last year, the Australian 2023 federal budget announcement on 9 May 2023 included Pillar Two announcements. The income inclusion rule will apply to financial years starting on or after 1 January 2024 and the undertaxed profits rule will apply to financial years starting on or after 1 January 2025. A 15% domestic minimum tax will apply for in-scope multinationals for financial years starting on or after 1 January 2024.

Australia: 2023 federal budget

Another key announcement in Australia's federal budget was a significant expansion of the general anti-avoidance rule (GAAR). This will be expanded to apply to schemes that: reduce tax paid in Australia by accessing a lower withholding tax rate on income paid to foreign residents; or achieve an Australian income tax benefit, even where the dominant purpose was to reduce foreign income tax.

This change applies to financial years starting on or after 1 July 2024, even if the scheme was entered into before that date. The expansion of GAAR will increase the importance of ensuring there is evidence that commercially supports the tax positions adopted.

Canadian 2023 Federal Budget

The Canadian 2023 Federal Budget Bill received its first reading on 20 April 2023. It includes some of the outstanding tax measures from the 2021 and 2022 federal budgets, including changes related to:

- mandatory disclosure rule (MDR);
- reporting rules for digital platform operators;
- hedging and short selling by Canadian financial institutions;
- borrowing by defined benefit pension plans; and
- reporting requirements for registered retirement savings plans and registered retirement income funds.

The expanded MDR generally requires individuals, corporations, trusts and partnerships to promptly disclose certain 'reportable transactions' and 'notifiable transactions' to the Canada Revenue Agency (CRA), among other new obligations. The government recently updated the rules for these transactions with new relieving amendments, including to extend the disclosure deadline to within 90 days (from 45 days) of entering into the transaction and narrow the scope of reportable transactions. These rules will apply to transactions entered into on or after the date the legislation to enact these changes receives royal assent, which is expected soon.

Certain corporate taxpayers will also have to disclose information about uncertain tax treatments reflected in their financial statements for taxation years that begin on or after 1 January 2023.

Taxpayers will need to assess whether they have new reporting obligations under these rules as failure to make the proper disclosures could lead to onerous penalties as well as extended reassessment periods.

Engie: AG opinion on Luxembourg tax rulings

On 4 May 2023, Advocate General (AG) Juliane Kokott of the CJEU rendered her opinion in *Engie*, the joined cases C-451/21 P and C-454/21 P, concerning two sets of tax rulings granted by the Luxembourg tax authorities in relation to the intra-group financing structures of a French group.

As a reminder, on 20 June 2018, the European Commission (EC) issued a decision that the rulings constituted illegal state aid, because the result of the structures approved by the tax administration was that almost all of the profits of the subsidiaries established in Luxembourg were not taxed. The taxpayers and Luxembourg tax authorities initiated a judicial action before the General Court of the EU, which upheld the EC's decision in 2021. Both the taxpayer and Luxembourg appealed the General Courts judgment before the CJEU.

The AG has concluded that tax rulings under dispute do not represent a selective advantage in favour of the taxpayer, and therefore that the CJEU should set aside the judgment of the General Court and annul the related EC decision.

The current AG decision is the latest in a string of cases related to European Commission state aid investigations into individual tax rulings granted by member states. Unlike other tax-related state aid cases where the focus of the EC was on allegedly unjustified transfer pricing or allocation of profits, the present case deals with internal mismatches and a supposed inconsistent application of national law, leading to double non-taxation.

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Several points from the AG opinion are noteworthy. First, the suggestion that the EC and the courts of the EU should adopt a limited standard of review, reduced to a plausibility check, when assessing individual tax rulings for compliance with state aid rules. The AG emphasised the need to ensure that only manifestly incorrect tax rulings under the relevant national law are scrutinised by the EC or the courts of the EU. Otherwise, in the AG's view, the Commission would become a de facto tax inspector and the courts of the EU would play the role of the supreme tax courts. This outcome would infringe on the member states' fiscal autonomy and would also significantly overburden both the EC and the courts of the EU. It would be very interesting to see if the CJEU will adopt the same line of reasoning and the limited standard of review.

Secondly, the current proceedings mark the first occasion for the court to address whether the misapplication or non-application of a general anti-abuse rule in national tax law constitutes state aid under the Treaty on the Functioning of the EU. In this context, the AG also recommended a limited standard of review, reduced to a plausibility check. If the CJEU decides to adopt this approach, the EC would have a higher burden of proof. As such, the EC would need to establish a clear failure by tax authorities to apply domestic anti-abuse rules. It would not suffice to demonstrate how such rules would generally apply to other taxpayers, but rather the EC would be required to prove a clear non-application in comparison to taxpayers in similar factual and legal circumstances.

AG opinions are non-binding on the CJEU, so it remains to be seen if the CJEU will follow the AG's recommendations. Once the CJEU decision is issued, it will also be interesting to see whether the Commission will put on hold or dismiss the in-depth investigations still pending at their level.

EU: elements of 'fit for 55' package adopted

In a significant milestone in the EU's commitment to tackling climate change, on 25 April 2023 the Council of the EU formally adopted the new carbon border adjustment mechanism (CBAM) and the reform of the European Union emissions trading system (ETS). The laws were previously adopted by the European Parliament and will enter into force 20 days after they are published in *The Official Journal of the EU*.

The revision of the EU ETS entails extending the covered sectors to include maritime transport, phasing out free allowances, reducing the number of allowances in circulation, and creating a new, separate ETS ('ETS II') for the transport and real estate sectors with regard to the emissions released during road transport and the heating of buildings.

The CBAM, which mirrors and is a supplementary measure to the EU ETS, operates by imposing a charge on the embedded carbon content of certain imported products. This is equal to the charge imposed on the production of domestic goods under the ETS (net of free permits), with adjustments made to this charge to take into account any mandatory carbon prices effectively paid in the exporting country.

The most urgent requirement for EU companies to be CBAM compliant is the adherence to reporting obligations from 1 October 2023. Businesses are required to report, on a quarterly basis, the embedded emissions in the imported goods (during that quarter of a calendar year). As part of their reports, businesses must detail both the direct and indirect emissions, as well as any carbon price effectively paid in the country of origin.

Businesses will be required to fully adapt to the CBAM regulations by 1 January 2026. Before this date, importers of CBAM goods in the EU must acquire the status of authorised CBAM declarant. Without it, they will no longer be able to import these goods into the EU customs territory.

CBAM is certain to have a disruptive impact on the companies trading in the list of commodities covered by the regulation. It is also expected to have an impact on global trade more generally, as similar measures become the new normal. Countries such as Canada, New Zealand, Australia, India and the UK are already in discussion about a CBAM for their countries.

Lithuania: draft bill to transpose EU public CbCR

Finally, on 7 March 2023, the Lithuanian government published a draft law to transpose the EU public country-by-country reporting (CbCR) Directive (the Directive) into domestic law.

The rules will apply in Lithuania for financial years starting on or after 22 June 2024. Lithuania intends to apply the 'safeguard clause' to allow in-scope groups to temporarily omit for a maximum of five years information that would cause a significant disadvantage to the companies concerned, provided they can justify the reason for the omission.

Expect to see an increase in activity from other member states in the coming weeks as they attempt to meet the deadline of 22 June 2023 to transpose the Directive into domestic law. ■

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- International review for April (includes Pillar Two status table) (T Sarson, 25.4.23)
- The consequences of unlawful state aid (G Peretz, 5.3.15)
- News: EU approves carbon border tax (26.3.23)