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E-News from the EU Tax Centre

Issue 159 – August 5, 2022

KPMG's EU Tax Centre compiles a regular update of EU and international tax developments that can have both a domestic and a cross-border impact, with the aim of helping you keep track of and understand these developments and how they can impact your business.

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Infringement Procedures and CJEU Referrals

CJEU Referrals

Portuguese request for preliminary ruling on taxation of interest on bonds and debt instruments

On May 10, 2022, the Portuguese Supreme Administrative Court (*Supremo Tribunal Administrativo)* made a referral to the Court of Justice of the European Union (CJEU), requesting a preliminary ruling on the compatibility of the Portuguese taxation of interest on bonds and debt instruments with EU law. In the relevant case before the Portuguese Supreme Administrative Court, interest on bonds and debt instruments is subject to aggregation and, as a result, higher rates of Portuguese tax where that interest is paid by a financial institution which is not resident for tax purposes in Portugal.

The Portuguese Supreme Administrative Court has therefore asked the CJEU to consider whether this treatment is compatible with EU law if its result is that the rate of tax applicable to interest paid by a non-Portuguese resident bank is far higher than the rate (levy) that would apply had the income in question been paid by a bank that is resident in Portugal.

For more information, please refer to the preliminary ruling referral.

German BFH request for a preliminary ruling on treatment of portfolio dividends for trade tax purposes

On April 14, 2022, the German Federal Tax Court (Bundesfinanzhof or BFH) made a referral to the CJEU requesting a preliminary ruling on the compatibility of the treatment of portfolio dividends for German trade tax purposes (in 2001) with EU law.

When determining the taxable amount for German trade tax for the year 2001, dividends that were derived from holdings of less than 10 percent (free-float holdings) in foreign companies were required to be added back if and to the extent that those dividends had been deducted from the taxable amount in a previous step of the calculation. In contrast, where dividends that derive from free-float holdings in companies with a registered office in Germany, no deduction and no add-back of the dividends was required to take place in the calculation of the taxable amount for trade tax. The BFH asked the CJEU to consider if this difference in treatment is compatible with EU law.

For more information, please refer to the preliminary ruling referral.

EU Institutions

COUNCIL OF THE EU

Addressing distortions caused by Foreign Subsidies – compromise text of regulation

On July 15, 2022, the General Secretariat of the Council of the European Union published a letter that was sent to the Chair of the European Parliament International Trade Committee in respect of a proposal on foreign subsidies distorting the EU internal market. The letter endorses a compromise

package that was agreed at a meeting of the Permanent Representatives Committee on July 13, 2022. The letter therefore confirms that, if the European Parliament adopts its position on the compromise package at first reading, the Council would approve the European Parliament's position and the act should be adopted in the wording which corresponds to the European Parliament's position.

The regulation was first proposed by the European Commission in May 2021 and is intended to limit the regulatory gap in the EU Single Market, whereby subsidies granted by non-EU governments currently go largely unchecked, while subsidies granted by Member States are subject to close scrutiny. The regulation is intended to reduce the distortions created by subsidies granted by non-EU countries to companies operating in the EU's single market. It introduces a comprehensive framework for the Commission to examine any economic activity benefiting from a subsidy granted by a non-EU country thus, restoring fair competition between European and non-European undertakings operating in the internal EU market.

For more information, please refer to the Council of the European Union letter.

EUROPEAN PARLIAMENT

FISC sub-committee workshop on the role of tax incentives

On July 11, 2022, the European Parliament's Subcommittee on Tax Matters (FISC) held a public hearing on *"the role of tax incentives and exemptions in the framework of the reform of corporate taxation and in the promotion of European economies' competitiveness"*. The aim was to gather insights and opinions from experts on the effectiveness and economic relevance of tax incentives for investment in the EU as well as their impact on the competitiveness of Member States and the European Union as a whole.

During the hearing, Benjamin Angel, Director of the European Commission's DG TAXUD division stated that, while tax incentives are useful tools for Member States, they are tools which should be used with care. In this regard, it was noted that tax incentives can be applied to help achieve wider public policy aims by incentivizing the desired behaviors from the public. However, it was also noted that tax incentives can at times be costly in design, inefficient and even socially regressive in certain cases. Mr. Angel also warned that an accumulation of tax incentives can also give rise to unnecessary complexity for taxpayers.

For more information, please refer to the European Parliament website.

OTHER EU INSTITUTIONS

European Economic and Social Committee opinion on the Minimum Tax Directive

On July 29, 2022, an opinion of the European Economic and Social Committee (EESC) was published in the Official Journal of the European Union on the proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union (the Minimum Tax Directive proposal). The opinion welcomes the fact that the European Commission is working in line with international discussions and notes that the "effectiveness and fairness of the global minimum tax reform heavily relies on its worldwide implementation". The EESC supports the Commission's view that a uniform application of the OECD Model Rules in the EU is required and states that this can only be achieved if legislation is enacted centrally and transposed in a uniform fashion.

In addition, the EESC opinion supports all efforts to reduce compliance costs for taxpayers, noting particularly the ongoing OECD work on the design of potential safe harbors, simplified administrative filing rules etc. and states that any such measures should be included in the Minimum Tax Directive. The EESC opinion also states that deliberate incentives introduced by Member States to foster

employment and attract investment should not be neutralized by the Model Rules, particularly noting that taxation should be used as a tool to promote a greener and digitalized economy.

The EESC is an advisory body that is consulted and provides opinions on EU initiatives. However, it is important to note that the EESC's opinion is not binding on the Council of the European Union (i.e. it would remain up to the 27 EU Member States to agree on the final text of the Directive).

For more information, please refer to the EESC opinion.

European Economic and Social Committee opinion on the Unshell Directive

On July 29, 2022, an opinion of the EESC was published in the Official Journal of the European Union on the proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (the Unshell Directive or ATAD III proposal). The opinion states that the EESC is fully supportive of the European Commission's proposal and welcomes the fact that the Commission held a wide public consultation process on the proposed Directive text.

The EESC opinion supports the decision to introduce measures to address the misuse of shell entities via a Directive aimed at ensuring a common legal framework among Member States, stating that the EESC believes these objectives could not be achieved through single initiatives by Member States in their national legislation. The EESC believes the Unshell Directive is proportionate in its design. In this regard, the EESC underlines the need to establish common and clear rules on the specific content of the declarations required from undertakings, stating that overreporting – going beyond the Directive objectives, and the resulting compliance costs, should be avoided.

The EESC also states that, in order to correctly manage the necessary checks and resulting information being exchanged under the proposed Directive, it will be important that the Commission and national tax authorities have adequate capacity in terms of skills and resources to do so. The EESC hopes that checks will be carried out with regard not only to corporate income but also to assets, and hopes that the results of investigations into the use of shell entities will be made transparent to the public.

In addition, the EESC recommends that targeted rules to prevent the activity of 'professional enablers' be laid down in a different legislative proposal. The Commission has separately launched a public consultation process on this topic (for more information, please refer to E-News Issue 158).

As noted above, the EESC is an advisory body that is consulted and provides non-binding opinions on EU initiatives.

For more information, please refer to the EESC opinion.

OECD and other International Institutions

OECD

Progress report on harmful tax practices

On July 27, 2022, the OECD published new conclusions reached by the Forum on Harmful Tax Practices (FHTP), as part of their on-going review of the implementation of the BEPS Action 5 minimum standard on harmful tax practices. The update covers assessments of the following twelve regimes:

- Armenia's free economic zones regime and the tax treatment of information technology

projects were concluded as potentially harmful.

- Cabo Verde's Maio special economic zone regime is under review for the first time.
- Costa Rica's free trade zone regime was amended to be in line with the BEPS Action 5 standard and was concluded to be not harmful.
- Eswatini made commitments to amend its special economic zones regime.
- Greece's tax patent incentive regime was amended to be in line with the BEPS Action 5 standard and was concluded to be not harmful.
- Honduras made commitments to amend or abolish both its free zones regime and employment and economic development zones regime.
- Italy abolished its patent box regime.
- Kazakhstan's Astana international financial centre regime and special economic zones regime were amended to be in line with the BEPS Action 5 standard and were concluded to be not harmful.
- Pakistan's export regime on IT was concluded as potentially harmful.

In addition, the FHTP's Harmful Tax Practices report includes the results of the review of the substantial activities factor for no or only nominal tax jurisdictions, including:

- Recommendations for substantial improvement made for Anguilla, the Bahamas, Barbados and the Turks and Caicos Islands.
- Specific monitoring areas identified for Bahrain, Bermuda, the British Virgin Islands and the Cayman Islands.
- No issues identified for Guernsey, Jersey, the Isle of Man and the United Arab Emirates.

For more details, please refer to OECD's press release.

Local Law and Regulations

Austria

Implementation of DAC7

On July 19, 2022, the Tax Amendment Act 2022 was published in the Official Gazette which provides for rules to transpose the Council Directive (EU) 2021/514 (DAC7) into Austrian domestic law. The law requires digital platform operators to provide the Austrian tax authorities with information about certain users ("sellers") on their platform, to enable the Austrian tax authorities to exchange this information with other EU Member States.

Belgium

Tax reform announced

On July 18, 2022, the Belgian Minister of Finance announced a tax reform to reduce labor taxation. Key corporate income tax adjustments include:

- the introduction of a minimum tax in line with the OECD Pillar Two solution;
- a reduction of the withholding tax on dividends, interest and royalties from 30 percent to 25 percent;
- the reduction of the corporate income tax rate from 20 percent to 15 percent for small and medium sized enterprises (SMEs) on the first EUR 200,000 of profits realized (currently EUR 100,000);

- the introduction of a 15 percent tax rate on capital gains resulting from the sale of shares and other assets under certain conditions.

Guidance on the taxation of cryptocurrency and NFTs

On July 22, 2022, the Belgian tax authorities published guidance, which provides clarifications on the tax treatment of cryptocurrencies and non-fungible tokens (NFTs).

According to the guidance, cryptocurrencies are considered as foreign currencies for tax purposes and are subject to corporate income tax (companies) or personal income tax (individual entrepreneurs). By contrast, cryptocurrency gains derived from non-business-related activity (i.e. private asset management) are exempt from personal income taxation.

The guidance further notes that capital gains resulting from the sale of NFTs are treated as regular capital gains, regardless of the payment method, at the generally applicable tax rates of 25 percent (corporate income tax) and 33 percent (personal income tax).

France

Rejection of the proposed windfall profits tax

On August 1, 2022, the French Senate rejected the proposal for a windfall profits tax to be levied on companies in the energy and freight transport sector at a rate of 25 percent on the surplus profits in 2022 and 2023. The Senate's decision followed the National Assembly's vote against such a measure on July 23, 2022.

Germany

Proposed changes to the taxation of payments for IP rights in 2022 Tax Act draft bill

On July 28, 2022, the German Ministry of Finance published the draft bill of the Annual 2022 Tax Act, which includes proposed changes to the taxation of persons subject to limited tax liability that derive German income from the assignment of rights entered in a German public record or register (so-called register cases). This follows the previously issued guidance prolonging the application of a simplified procedure for non-resident tax liability arising from transfers of rights in cases when the right is merely entered into a German public register (please refer to E-News Issue 157).

According to the draft bill, payments in relation to such register cases should no longer give rise to limited tax liability as from January 1, 2023. For payments between unrelated parties, the abolition of the limited tax liability would apply retroactively, i.e. for all open cases including payments before January 1, 2023. Only where the income is earned by a person resident in a non-cooperative tax jurisdictions within the meaning of the German Tax Haven Defense Act (please refer to E-News Issue 136), the limited German tax liability for register cases would be upheld in the future.

The draft bill is subject to technical consultation and stakeholders are invited to make comments until August 11, 2022.

As a next step, the draft bill is subject to approval by the government and then adoption by the German Parliament (Bundestag) and Federal Council (Bundesrat).

Netherlands

Update on consultation regarding options to address dividend stripping

On July 15, 2022 the Dutch Deputy Minister of Finance sent a letter to the Lower House of Parliament providing a summary of the responses to the consultation regarding options for strengthening measures to prevent dividend stripping and outlining the government's current assessment of the options (for previous coverage, please refer to E-News Issue 145).

According to the letter, proportionality is central to any decision to opt for new measures, so that only abuse situations and not bona fide cases will be affected. The government is therefore examining measures that focus on improving the information and evidentiary backlog at the Dutch Tax and Customs Administration, including changing the current division of the burden of proof. In addition, the government will be examining whether it is possible to develop a robust, proportional and easily implementable measure on the basis of introducing a net return/tax base approach for the crediting or refunding of dividend tax and expanding the scope to cover associated entities.

It is expected that the measures to strengthen the approach to dividend stripping will not be introduced before January 1, 2024.

For more details, please refer to a report prepared by KPMG in the Netherlands.

Romania

Amendments to domestic tax code

On July 15, 2022, a Government Ordinance amending the Romanian tax code was published in the Official Gazette (for previous coverage, please refer to E-News issue 158). Key corporate tax measures include:

- an increase of dividend withholding tax on payments made to non-resident companies – from 5 percent to 8 percent, where the local rules implementing the EU Parent-Subsidiary Directive do not apply;
- changes to the micro-company regime, both in terms of scope and revenue threshold below which companies can opt for the regime.

For more details, please refer to a report by KPMG in Romania.

Spain

Draft legislation to introduce windfall profit taxes on energy companies and banks

On July 28, 2022, the Spanish government submitted a draft bill to the Parliament proposing to impose a new windfall profit tax on certain energy companies as well as on banks (for previous coverage, please refer to E-News Issue 158).

The draft bill proposes a levy of 1.2 percent on domestic power utilities sales by energy companies with an annual (consolidated) turnover exceeding EUR 1 billion in 2019. In addition, the draft bill provides for a 4.8 percent levy on the net interest income and net commissions of banks, where such income exceeded EUR 800 million in 2019.

Both levies would apply in 2023 and 2024 and would not be deductible from the corporate income tax liability.

As a next step, the draft bill is subject to adoption by the Spanish Parliament.

United Kingdom

Draft legislation to implement Pillar Two published

On July 20, 2022, the UK government published draft legislation and accompanying detailed explanatory notes to implement Pillar Two into domestic law. The draft legislation confirms that the Income Inclusion Rule (IIR) under Pillar Two would first apply to accounting periods beginning on or after December 31, 2023.

Alongside the draft legislation, a summary of consultation responses was published confirming that the UK government will also introduce an Undertaxed Profits Rule (UTPR). However, a decision on timing for the UTPR will be made at a later date when the progress and extent of Pillar Two implementation in other jurisdictions can be assessed. The consultation response document also confirms that the UK government is still considering the implementation of a domestic minimum tax depending on the implementation of IIR and UTPR in other countries, the process for determining whether a domestic minimum tax is qualified in the implementation framework and whether there would be a safe harbor from the IIR or UTPR when a jurisdiction has a qualified domestic minimum tax.

The draft legislation is subject to technical consultation and stakeholders are invited to make comments until September 14, 2022.

For more details, please refer to KPMG's Tax News Flash.

Local Courts

France

Supreme Court decision on full refund of capital gains withholding tax

On June 23, 2022, the French Supreme Court (Conseil d'Etat) issued a decision in a case concerning a refund of capital gains withholding tax requested by a taxpayer based on EU law arguments. The case concerns a Monaco tax resident who was subject to a 33.33 percent French capital gains withholding tax on the proceeds from the disposal of French real estate.

Under French rules applicable at that time, the domestic withholding tax rate applied to individuals on capital gains realized varied depending on the tax residence of the individual – i.e. 19 percent in cases where the seller was an EU/EEA resident and 33.33 percent if the seller was resident in a third country. Following a decision issued by the French Supreme Court, which took the view that the imposition of a higher rate on third country residents was incompatible with the principle of free movement of capital under the EU treaty, the rate applicable to third country residents was reduced to 19 percent with effect from 2015 onwards.

The French Supreme Court rejected the taxpayer's claim to a full tax refund of the 33.33 percent tax withheld in France. Instead, the Supreme Court held that a partial refund – to account for the difference between the 33.33 percent tax withheld and the 19 percent tax applicable to French residents, would put the plaintiff in the same position as a French tax resident individual. This latest ruling appears to be contradictory to a previous ruling issued on October 14, 2020, in which the French Supreme Court seemed to have held that a full refund should have been granted to the non-resident taxpayer in a case

concerning withholding tax on capital gains on substantial participations (for more details, please refer to E-News Issue 122).

Supreme Court backs fraud detection program based on 'freely accessible' data

On July 22, 2022, a decision was issued by the French Supreme Court in relation to Decree no. 2021-148 of February 11, 2021. This decision involved the implementation of computerized and automated processes allowing for the collection and use of data made public on the websites of online platform operators. This method of data collection/utilization was introduced on an experimental basis for a period of three years as part of the Finance Law for 2020.

Such collection was challenged by La Quadrature du Net (LQDN), a French advocacy group for digital rights and freedoms, which demanded that the decree should be terminated and all information collected since the decree was introduced should be deleted. The Supreme Court, in its decision, found that the primary argument of the LQDN that the decree authorized a generalized and undifferentiated collection of information was inaccurate. On this basis, LQDN's request was rejected.

Netherlands

Interest deductions in acquisition structures (Dutch Supreme Court)

On July 15, 2022, the Dutch Supreme Court (Hoge Raad) issued two judgments on the deduction of interest on loans that served to finance external acquisitions by private equity funds.

Both cases concerned structures involving a Dutch company, indirectly held – through a Luxembourg company – by several private equity sub-funds and other co-investors. In both cases, the Luxembourg parent raised funds from its shareholders through the issuance of preferred equity certificates. The funds were used to grant a loan to the Dutch subsidiary, which in turn used the loan to fund the acquisition of an external target (a Dutch holding company and its subsidiaries). Following a dispute with the Dutch tax authorities concerning the deductibility of the financing costs (i.e. interest expenses incurred in relation to the loan used to acquire the target group), two lower Dutch courts held that the interest was not deductible. The lower courts based their reasoning on an article included in the Dutch Tax Code, under which financing costs related to loans received from associated parties and used to acquire other companies represent an 'intra-group (non-business motivated) diversion' and are not deductible for tax purposes.

However, the Dutch Supreme Court held in both cases that the sub-funds holding the preferred equity certificates do not qualify as associated parties for the purpose of the relevant Dutch rules. Therefore, in the Dutch Supreme Court's view, the funds used by the Dutch subsidiary for the external acquisition were not considered to have been 'diverted' and the related interest expenses did not fall within the scope of the interest deduction limitation article cited by the tax inspectors and the lower courts.

For more details, please refer to a report prepared by KPMG in the Netherlands.

United Kingdom

Upper Tribunal decision in case regarding the non-deductibility of interest expenses

On July 19, 2022, a decision was reached by the UK Upper Tribunal in a case concerning the deductibility of interest expenses arising from loans used by a UK business to acquire the North American investment business of a financial institution. The Upper Tribunal determined that, as the loan structure which was used to finance the group's acquisition of the North American investment

management business in December 2009 violated the arm's-length principle, the interest and other expenses paid on intragroup loans should be treated as non-deductible.

The judgment held that the interest and other expenses are non-deductible as the only purpose of the loans was to secure a tax advantage and that it was not "just and reasonable to apportion the debits to the commercial purpose rather than the tax advantage purpose". In addition, the Upper Tribunal also stated that a third-party lender would not have entered in the arm's length transaction in order to make such loans without additional covenants, which were not present in the actual transaction.

In reaching its decision, the Upper Tribunal opposed the decision by the First-Tier Tribunal (FTT) ([2020] UKFTT 443 (TC)), which held that the loans were consistent with arm's length transactions and the interest expenses were fully deductible to a non-tax commercial objective. The Upper Tribunal concluded that the had FTT made a mistake by comparing the actual transaction with a hypothetical transaction, which included the covenants and held that the "hypothetical transaction must be sufficiently comparable with the actual transaction for the purpose of testing it" and that the test of sufficiently comparable rests on an assessment of the "economically relevant characteristics."

KPMG Insights

2022 KPMG Africa Tax Virtual Conference

On July 20, 2022, KPMG hosted the 2022 KPMG Africa Tax Virtual Conference where we looked towards how the next chapter for tax matters in Africa will unfold for the remainder of 2022 and beyond. What insights will be revealed that will help leaders of tax functions adjust their vision and set a different course to operate within the new business realities of Africa?

The KPMG Head of Tax for the Africa Region opened the conference with a fireside chat with the KPMG EMA Region Head of Tax who shared his experience working with tax leaders across the region who are tasked with leading and developing their tax functions of the future.

In addition, Senior KPMG member firm leaders delivered panel discussion sessions, together with tax leaders from leading multinational organizations and regulatory and revenue authorities diving deeper into two of the most pressing tax issues that continue to impact African operations including:

- What challenges the recent BEPS 2.0 developments may present and how might the story unfold?
- How to reimagine the tax and finance functions of the future.

For a replay of the conference, please access the event page.

KPMG Withholding Tax Study 2022

The 15th edition of the withholding tax (WHT) study prepared by KPMG in Luxembourg analyzes the WHT rates of 124 jurisdictions applicable on interest, dividends and capital gains derived by Luxembourg UCITS SICAVs and FCPs based on their legal status as of 1 January 2022.

In addition to the analysis, the study provides further insight into topics like Mandatory Disclosure Rules (DAC6), FATCA and developments in CSR and the sustainable investments sector.

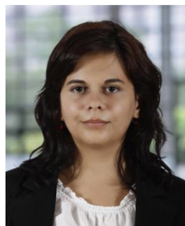
For more information, please refer to the KPMG withholding tax study.

KPMG Middle East & South Asia (MESA) Tax Guide

Tax leaders of today need to be up to date with the changing tax landscapes and keep themselves informed of the cross-border taxation policies. The 2022 edition of the Middle East and South Asia (MESA) Tax Guide — KPMG's flagship thought leadership publication on tax in the MESA region – provides a summary of the general framework required to do business in each of the countries, along with some insight on tax and regulatory provisions.

The KPMG MESA Tax Guide can be accessed here.

Raluca Enache
Director
KPMG's EU
Tax Centre



Ana Puscas
Manager
KPMG's EU
Tax Centre

Cormac Golden
Associate Director
KPMG's EU
Tax Centre

Marco Dietrich
Manager
KPMG's EU
Tax Centre

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