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E-News from the EU Tax Centre

Issue 181 – August 4, 2023

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. Today's edition includes updates on:

- **CJEU:** Decision on primacy of EU law and the application of the more lenient criminal law in VAT evasion cases
- **European Commission:** Luxembourg referred to CJEU for failing to correctly transpose the interest limitation rules under ATAD
- **European Commission:** Letter of formal notice sent to multiple Member States for failure to notify the transposition of the EU Public Country-by-Country Reporting Directive and to Hungary to align its corporate income tax rules with ATAD
- **European Commission:** Reasoned opinion sent to several Member States for incomplete transposition of DAC7 into national law
- **OECD:** New releases on Pillar One and Pillar Two releases (GloBE Information Return, Administrative Guidance, Subject to Tax Rule, Amount B consultation, Outcome Statement)
- **Croatia:** Implementation of the EU Public CbyC Reporting Directive
- **Germany:** Draft business tax reform bill published
- **Ireland:** Release of Feedback Statement regarding Pillar Two application
- **Luxembourg:** Draft bill on investment tax credits
- **Italy (court decision):** Supreme Court decision on beneficial ownership of domestic interest payments

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Latest CJEU, EFTA and ECHR

CJEU

Advocate General opinion on Portuguese additional solidarity tax on the banking sector

On July 13, 2023, Advocate General (AG) Pikamäe of the Court of Justice of the European Union (CJEU or the Court) rendered his opinion in case C-340/22. The opinion concerns the compatibility of the Portuguese additional solidarity tax on the banking sector with EU law.

On July 24, 2020, Portugal introduced an additional solidarity tax on the banking sector (Adicional de Solidariedade sobre o Sector Bancário or ASSB). Both credit institutions tax resident in Portugal and Portuguese branches of credit institutions resident in other Member States are liable to pay the ASSB. The tax is levied on the adjusted liabilities and notional value of off-balance sheet derivative financial instruments of credit institutions. Certain elements, such as own funds and comparable debt instruments, can be deducted from the ASSB taxable base. Arguably[1], due to the fact that entities without legal personality are not able to issue own funds, branches are not able to deduct such elements (as opposed to Portuguese credit institutions or Portuguese subsidiaries of credit instructions resident in other Member States).

The plaintiff, a Portuguese branch of a French credit institution, challenged the legality of the ASSB on the grounds that the tax breaches EU law. The plaintiff pleaded that i) the ASSB was not compliant with Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms; ii) the difference in treatment between credit institutions resident in Portugal and branches of non-resident credit instructions represents a restriction on the freedom of establishment. The case was referred to the CJEU, which asked the AG to express his opinion solely on the freedom of establishment point.

The AG first rejected the Commission's written observation, based on which any indirect discrimination that may arise resulted from the legal status of branches, which are unable to have own funds – and not from the legislation under dispute. The AG recalled that based on settled case-law, the freedom of establishment precludes a difference in tax treatment for non-resident companies operating through a subsidiary or a branch in the host Member State. The AG also disputed the relevance of case C-686/13 (X AB) invoked by the Commission. In this respect, the AG noted that the indirect discrimination in the X AB case resulted from the combined effect of rules in force both in the host state of the branch and the state where the head-office was tax resident. On the other hand, the discrimination in the case at hand does not result from a disparity of tax systems but from the rules in the host state. The AG concluded that the ASSB triggers an indirect discrimination against non-resident credit institutions wishing to establish themselves in Portugal through a branch, which is prohibited by the freedom of establishment.

The AG continued by analyzing and subsequently rejecting all possible justifications for the restriction identified. In the specific case of the need to ensure a balanced allocation of tax powers among Member States, the AG noted the arguments put forward by the Commission. As such, in the Commission's view, the measure at hand intends to protect Portugal's taxing rights – by ensuring that branches do not artificially deduct debt instruments comparable to own funds that are not linked to the activity carried out in Portugal. The AG rejected the plea by noting that Portugal waived taxing powers in respect to own funds elements for

[1] The applicant is of the view that the deduction of own funds from the tax base for the ASSB is not available to entities which do not have legal personality, such as branches of non-resident credit institutions, since those entities are legally devoid of own funds. However, the Portuguese tax authorities and the Portuguese government disagree with this interpretation.

resident credit institutions and subsidiaries of non-resident credit institutions. As such, in the AG's view, it would not be consistent to rely on taxing rights arguments to justify a less favorable treatment of branches.

Based on the above, the AG recommended that the CJEU finds the measure under dispute as being in breach of EU law.

Decision on primacy of EU law and the application of the more lenient criminal law in VAT evasion cases

On July 24, 2023, the CJEU issued its decision in case C-107/23, re-confirming the primacy of EU law over domestic legislation, including decisions of a Constitutional Court. The case also concerns the application of the more lenient criminal law (*lex mitior*) in VAT evasion cases.

The case involves a group of individuals (the plaintiffs) who were involved in the sale of diesel fuel to national recipients under an excise duty suspension regime. However, they failed to record these transactions in their accounting documents, leading to a loss to the State budget with respect to VAT and excise duty on diesel fuel. In 2020, the appellants were convicted of tax evasion and of being part of an organized criminal group.

In 2018, the Romanian Constitutional Court (the Constitutional Court) found that the article of the Criminal Code which provided for the limitation period for criminal liability to be interrupted by "any procedural act" - irrespective of whether it was notified or not to the suspect, was unconstitutional. The plaintiffs appealed their conviction by pleading that the invalidation issued by the Court resulted in the removal of any grounds for interrupting the limitation period in criminal matters. The Court of Appeal Brasov referred the case to the CJEU asking for their interpretation on whether national courts could disapply Constitutional Court or Supreme Court rulings such as the ones above.

The CJEU noted that the Constitutional Court's decision led to a situation where Romanian law did not provide any ground allowing the limitation period for criminal liability to be interrupted. Moreover, a 2022 decision of the Romanian High Court of Cassation and Justice (High Court) held that constitutional case-law could be invoked as a more lenient criminal law (*lex mitior*), including to challenge final convictions. The CJEU also noted that, as mentioned by the referring court, the two decisions combined could lead to the termination of criminal proceedings and the removal of criminal liability in a substantial number of cases, which could create a systemic risk for the Romanian justice system.

The CJEU then noted that under Article 325(1) of the Treaty on the Functioning of the European Union (TFEU), in cases concerning serious fraud or other serious illegal activities affecting the financial interest of the EU, Member States are required to apply criminal penalties that are effective and act as a deterrent. Moreover, under Article 2(1) of the Convention on the protection of the European Communities' financial interests (PFI Convention), Member States have to ensure that fraud affecting the financial interest of the EU is punishable by effective, proportionate, and dissuasive criminal penalties.

The Court then analyzed whether national courts are required to disapply decisions issued by Constitutional Courts or Supreme Courts that are in breach of the EU law provisions above. The CJEU recalled its settled case-law based on which, in accordance with the principle of the primacy of EU law, national courts are required to disapply any national rule or practice that is contrary to a provision of EU law with direct effect. In this respect, the Court noted that the two EU law provisions above are formulated in clear and precise terms and are not subject to any conditions, and therefore they have direct effect. Based on these considerations, the CJEU held that, in principle, national courts are required to disapply national provisions which, in connection with proceedings concerning serious fraud affecting the financial interests of the EU, prevent the application of effective and deterrent penalties to counter such offenses.

The Court continued by analyzing whether, in the case at hand, the obligation to disapply such judgments conflicts with the protection of fundamental rights. The Court noted that the provision invalidated by the Constitutional Court was in breach of the principle of legal certainty since it prescribed the interruption of the limitation period for criminal offenses even through acts not notified to the suspect. Therefore, and despite the risk of creating a systemic risk, the CJEU held that national courts could rule that the statute of limitation for criminal offences cannot be interrupted for the period when the national law did not require the notification of such acts to the suspect.

Infringement Procedures and Court Referrals

Luxembourg referred to CJEU for failing to correctly transpose the interest limitation rules under ATAD

On April 19, 2023, the European Commission (the Commission or the EC) referred Luxembourg to the CJEU for failing to correctly transpose the interest limitation rules under the EU Anti-Tax Avoidance Directive 2016/1164 (ATAD).

The referral follows a reasoned opinion sent by the Commission on December 2, 2021, calling on Luxembourg to amend its interest limitation rules. The Commission argued that Luxembourg's interest limitation rules contain a derogation for securitization entities, which are not financial undertakings within the exhaustive list of financial undertakings in Article 2(5) of ATAD. For more details, please refer to E-News Issue 144.

As Luxembourg did not satisfactorily address the Commission's concerns, the EC decided to refer the case to the CJEU.

For more information, please refer to the Commission's press release.

Letter of formal notice sent to multiple Member States for failure to notify the transposition of the EU Public Country-by-Country (CbyC) Reporting Directive

On July 20, 2023, the Commission sent letters of formal notice to fourteen Member States that had not notified national measures transposing the EU Public CbyC Reporting Directive (Directive) into domestic legislation. These Member States are: Austria, Belgium, Bulgaria, Croatia, Czechia, Cyprus, Estonia, Finland, Greece, Italy, Latvia, Luxembourg, Malta, Netherlands, Poland, Portugal, Slovenia. Member States were required to implement the Directive by June 22, 2023.

The deadline for Member States concerned to reply to the letters of formal notice and complete their transposition is two months. Should they fail to do so, the Commission may decide to issue a reasoned opinion. The letters of formal notice have not been made publicly available by the EC. Since then, Croatia and Luxembourg adopted the rules. Belgium, the Czech Republic, Netherland and Poland have also published draft legislation.

For more details, please refer to the Commissions' press release and Euro Tax Flash Issue 520.

Letter of formal notice sent to Hungary to align its corporate income tax rules with ATAD

On July 14, 2023, the Commission announced that a letter of formal notice had been sent to Hungary requesting the alignment of domestic tax rules with ATAD. The Commission argued that they identified divergent rules on the taxation of Controlled Foreign Companies (CFCs). In addition, the Commission considered that the domestic definition of "associated enterprise" is not aligned with the one under ATAD, since it does not include subsidiaries under common control. Hungary has two months to respond to the letter, after which the Commission may decide to send a reasoned opinion.

For more details, please refer to the Commissions' July 2023 infringement package.

Reasoned opinion sent to several Member States for incomplete transposition of DAC7 into national law

On July 14, 2023, the EC decided to send a reasoned opinion to several Member Stats that had failed to notify the national measures transposing Council Directive (EU) 2021/514 (DAC7) into domestic legislation. These Member States are Belgium, Greece, Spain, Cyprus, Poland and Portugal.

DAC7 introduces an obligation on platform operators to provide information on income derived by sellers through the platform and allows tax authorities of EU Member States to collect and automatically exchange such information. Member States had until December 31, 2022 to transpose the rules into national law. The Commission had previously sent letters of formal notice to these Member States – see E-News Issue 170. Belgium, Greece, Spain, Cyprus, Poland and Portugal have two months to reply and take the necessary measures. In the absence of a full communication of all national implementing measures, the Commission may decide to refer the case to the CJEU.

The Commission has also decided to close the infringement procedure opened against Slovenia for failure to communicate the DAC7 transposition.

For more details, please refer to the Commissions' July 2023 infringement package.

State aid

European Commission approves Hungarian scheme under the State aid Temporary Crisis and Transition Framework

On July 28, 2023, the European Commission approved a EUR 2.36 billion Hungarian scheme for accelerated investments in strategic sectors to foster the transition to a net-zero economy. The scheme was approved under the State aid Temporary Crisis and Transition Framework (TCTF), that was adopted by the Commission on March 9, 2023, as part of the broader Green Deal Industrial Plan for the Net-Zero Age. For more information, please refer to Euro Tax Flash Issue 508.

Under the Hungarian scheme, the aid will take the form of direct grants and tax advantages and will be available to companies producing relevant equipment, such as batteries, solar panels, wind turbines, heat-pumps, electrolysers, equipment for carbon capture usage and storage, as well as key components designed and primarily used as direct input for the production of such equipment or related critical raw materials necessary for their production.

For more details, please refer to the Commission's press release and the below summary of recent Hungarian tax law amendments.

EU Institutions

Council of the EU

Outcome of July 14 ECOFIN meeting

On July 14, 2023, the first scheduled meeting of the Economic and Financial Affairs Council of the EU (ECOFIN) under the Spanish Presidency of the Council took place. Key takeaways from the meeting include:

- The Spanish Presidency updated ministers on the Pillar One negotiations at OECD/G20 Inclusive Framework level with reference being made to the Commission's progress report (see E-News Issue 180 for reference) and the OECD's Outcome Statement (see below for reference).
- Member States raised concerns in respect of the Commission's proposal for an adjusted package of new own resources (in particular, in relation to the statistical own resource based on company profits).
- The Spanish Presidency presented its work program for the second half of 2023 and noted that it aims to reach agreement on a general approach on several "important files" (which reportedly include the Unshell Directive).

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

Code of Conduct Group work program under the Spanish Presidency

On July 7, 2023, the Council published the new work program of the Code of Conduct Group (Business Taxation) for the second half of 2023 under the Spanish Presidency. Key work items include:

- assessment of the progress made by jurisdictions in respect of the automatic exchange of information based on the results of the 2023 Global Forum peer reviews in order to identify remaining gaps ahead of the deadline for commitments in 2024 (criterion 1.1);
- work on the future criterion 1.4 on the exchange of beneficial ownership information;
- review of progress made by jurisdictions in relation to amending or abolishing preferential tax regimes – in particular foreign source income exemption regimes (criterion 2.1);
- monitoring of economic substance requirements for collective investment funds (CIVs) and partnerships as well as for trusts and other legal arrangements in close cooperation with the Forum on Harmful Tax Practices (criterion 2.2);
- assessment of commitments made by jurisdictions with regards to the application of the CbyC Reporting minimum standard following the Inclusive Framework peer review report in the autumn of 2023 (criterion 3.2);
- evaluation of the application of tax defensive measures applied by Member States towards non-cooperative jurisdictions;

- work on a further strengthening of the EU list and a gradual extension of its geographical scope.

For more information, please refer to the website of the Code of Conduct Group.

European Commission

Implementation of the Foreign Subsidies Regulation

On July 10, 2023, the European Commission (EC) issued rules for implementing the Foreign Subsidies Regulation (Regulation (EU) 2022/2560). The Implementing Regulation (FSR IR) aims to clarify practical and procedural aspects related to the application of the FSR that companies will need to follow in advance of concluding concentrations or public procurement bids. Key features include:

- the FSR IR includes notification forms for concentrations involving foreign financial contributions and for foreign financial contributions in public procurement procedures;
- transactions meeting the notification thresholds must be notified to the EC through a notification form detailing the financial contributions (not just subsidies) received from a non-EU government or government-controlled entity in the last three years;
- the notification thresholds are based on the value of all financial contributions received, including those below EUR 1 million in value;
- after notification, the EC will have 25 days to conduct a preliminary review the transaction and to decide whether to launch an in-depth investigation into whether the firm is in receipt of a foreign subsidy that could distort the EU market;
- the threshold for an individual contribution has risen from EUR 250,000 to EUR 1 million;
- contributions over EUR 1 million are only required to be disclosed if either (i) they fall into one of the categories of most likely distortive subsidies, or (ii) the combined value of all contributions received from that country in the past three years is over EUR 45 million (for concentrations) or over EUR 4 million (for public procurement bids);
- contributions that do not fall into one of the categories of most likely distortive subsidies set out in Article 5 of the FSR may be presented in aggregated form; and
- certain transactions, such as sale or purchase of goods on market terms, or non-selective tax deferrals, do not need to be disclosed.

The FSR entered into force on July 12, 2023 and the notification requirement will commence on October 12, 2023. For more information on the application of the FSR, please refer to our previous coverage in E-News Issue 179, and a detailed report by KPMG in the UK.

European Parliament

FISC sub-committee hearing on tackling the role of enablers

On July 17, 2023, the European Parliament's Subcommittee on Tax Matters (FISC) held a public hearing on ''Tackling the Role of Enablers Involved in Facilitating Tax Evasion and Aggressive Tax Planning in the European Union (SAFE)". The aim of the discussion was to gather insights and opinions from experts on the role of

enablers in facilitating tax evasion and aggressive tax planning with a view to an upcoming proposal by the European Commission. Key topics discussed included:

- differentiation between tax evasion and aggressive tax planning and the establishment of a workable definition of the term “aggressive tax planning”;
- the value of ethical frameworks to strengthen the ethical expectations of professional accountants and to guide their behaviors and actions when they are involved in tax planning or related services;
- due diligence procedures in respect of unregulated tax intermediaries who may not be obliged to undertake anti-money laundering (AML) procedures;
- adequate funding and resourcing of tax administrations from a knowledge and technology perspective to address the issues of “aggressive tax planning” and tax evasion.

Notably, the Chair expressed his regrets that a representative of the European Commission did not to attend the hearing. According to the Chair, this was due to the fact that the SAFE proposal was put on hold until an agreement is reached on the proposed Directive laying down rules to prevent the misuse of shell entities for tax purposes (the Unshell Directive proposal). See E-News Issue 180 for reference.

For more details, please refer to the European Parliament’s press release.

Discussion on the European Commission’s note on gold-plating the EU Public CbyC Directive

On July 13, 2023, the European Parliament held a discussion with Commissioner Mairead McGuinness regarding recommendations sent by the Commission to the Member States on the local transposition of the EU Public CbyC Reporting Directive. Key takeaways from the discussion include:

- according to the Commissioner, it is the Commission's duty to ensure and promote effective transposition of EU law in national legislation that maintains the level playing field;
- the Commissioner noted that in line with the better regulation guidelines agreed by the European Parliament, the Council and the EC, Member States should refrain from unjustified gold-plating, i.e. adopting transposition measures that go beyond the requirements of a Directive or that could disrupt the level playing field. As such, the Commissioner noted that the Commission helps Member States to keep national transposition as close as possible to what the co-legislators agreed;
- while the Commissioner advised that Member States are free to go further than the provisions of the Directive, she also noted that the letter sent by the EC to Member States in relation to the transposition of the EU Public CbyC Reporting Directive identified a number of areas where gold plating would raise concerns, including the scope of application, the content of a company’s report and the audit requirement for subsidiaries.

OECD and other International Institutions and Research Centers

Organisation for Economic Cooperation and Development – OECD

Release of final template and related commentary for the GloBE Information Return (Pillar Two)

On July 17, 2023, the OECD/G20 Inclusive Framework (IF) on BEPS released the final standardized template of the GloBE Information Return (GIR) with accompanying explanatory notes. The document outlines and describes the standard set of data points required to complete the GIR, including:

- *MNE Group Information (Section 1):* This section identifies both the filing constituent entity and the MNE group and asks for details about the reporting fiscal year, the financial accounting standard used to prepare the MNE's consolidated financial statements, the presentation currency of the financial statements and the corporate group structure. The section also contains a high-level GIR summary panel which needs to be completed for each jurisdiction and will be shared with tax administrations in every jurisdiction in which the MNE group operates.
- *Jurisdictional Safe Harbours and Exclusions (Section 2):* In this section MNE groups can elect to apply safe harbour provisions for a certain jurisdiction. Where the safe harbours or other exclusions apply, the MNE Group are generally not required to complete the detailed panels in Section 3 of the GIR. Note, however, that exceptions apply.
- *GloBE computations (Section 3*): This section includes detailed disclosures of the GloBE computations for each jurisdiction where the group operates including disclosures of the effective tax rate calculation, top-up tax calculation, as well as how top-up taxes are allocated between Constituent Entities. The GIR requires those disclosures to also be made for each Constituent Entity in the MNE Group, unless one of the following exceptions applies:
    - *Transitional relief:* during a transitional period (fiscal years beginning on or before December 31, 2028, but not including a fiscal year that ends after June 30, 2030), MNE groups can elect to provide the majority of Section 3 information only at an aggregated jurisdictional level provided that either no top-up tax liability arises or the top-up tax liability does not need to be allocated on a Constituent Entity basis (notably, a defined list of disclosures would still need to be completed on a Constituent Entity by Constituent Entity basis).
    - *Relief for tax groups:* the filing constituent entity may also elect to apply the aggregated reporting relief for tax consolidated groups that would treat the consolidated group as a single Constituent Entity provided that certain conditions are met. As such, detailed disclosures on an entity-by-entity basis would not be required for members of that group.

In addition, the GIR document clarifies which information will be shared with tax administrations globally. According to the agreed dissemination approach, all implementing jurisdictions are provided with the data included in Section 1 of the GIR. A jurisdiction which has taxing rights (under the regular GloBE rules or a QDMTT) will also receive sections of the GIR that relate to the ETR and Top-up Tax including how the top-up tax is allocated and attributed to those jurisdictions as well as information on the applicable safe harbours and exceptions. The jurisdiction of the UPE is provided with the whole GIR where it has implemented the GloBE rules.

In terms of next steps, the introductory notes note that the Inclusive Framework will finalize work on the automatic exchange of GloBE information between tax authorities which includes the development of a

framework of (bilateral or multilateral) competent authority agreements and IT-solutions to support the exchange of information (including a dedicated XML schema).

For more information, please refer to a dedicated KPMG report.

Release of second tranche of Administrative Guidance (Pillar Two)

On July 17, 2023, the OECD/G20 Inclusive Framework (IF) on BEPS released an agreed second tranche of Administrative Guidance (AG) that aims to clarify the interpretation and application of several elements of the GloBE Rules. The guidance covers five issues: QDMTT, Safe Harbours (covering both the QDMTT and Transitional Undertaxed Profits Rule (UTPR) Safe Harbour), tax credits, general currency conversion rules for the GloBE Rules and the Substance-based Income Exclusion ("SBIE").

- *QDMTT guidance:* the July AG supplements the QDMTT guidance from February and provides further guidance on the design and operation of a QDMTT that will be used for an assessment of whether domestic minimum top-up taxes adopted by IF members meet the requirements for qualified status. Both pieces of QDMTT guidance identify elements of the design of a QDMTT that would generally need to mirror the GloBE rules and those that need to deviate from same (e.g. taxes on distributions imposed at recipient level). In addition, the QDMTT guidance allows QDMTT jurisdictions to opt for certain variations from the GloBE Rules (e.g. no application of QDMTT on certain types of entities that are subject to a standalone ETR and Top-up Tax computation, different options to allocate QDMTT liability between local Constituent Entities). The guidance also allows QDMTT jurisdictions to design their own local QDMTT information return that follows different formats compared to the GIR, provided that equivalent data points are used.
- *QDMTT Safe Harbour:* the July guidance introduces an elective QDMTT Safe Harbour under which the GloBE Top-up Tax is deemed to be zero for jurisdictions that apply a domestic minimum top-up tax that reaches the qualified status under the OECD peer review (QDMTT) and that meets certain additional standards in relation to the use of the UPE's or local financial accounting standard and GloBE consistent application and administration of the QDMTT. Where the QDMTT Safe Harbour applies, GloBE jurisdictions are expected to provide for the exemption mechanism in their domestic legislation (instead of the generally applicable credit method for QDMTTs). Certain exceptions apply whereby the MNE Group will be required to apply the credit method for the QDMTT (i.e. the exemption method under the Safe Harbour is switched off) in relation to either all or a subset of CEs located or created in the QDMTT jurisdiction.
- *Transitional UTPR Safe Harbour:* the July guidance provides an elective Transitional UTPR Safe Harbour that an MNE Group can apply with respect to the jurisdiction where its UPE is located when that jurisdiction's nominal corporate tax rate is at least 20 percent. Under the safe harbour, the UTPR Top-up Tax Amount for the UPE jurisdiction is deemed to be zero for Fiscal Years that begin on or before December 31, 2025, and end before December 31, 2026. The guidance clarifies that while an MNE can choose either the Transitional UTPR Safe Harbour or the Transitional CbyC Reporting Safe Harbour for a jurisdiction in a particular year, it cannot apply both. Accordingly, if an MNE Group applies the Transitional UTPR Safe Harbour for the UPE, it ceases to be eligible for the Transitional CbyC Safe Harbour in future years under the "once out, always out" approach.
- *Guidance on tax credits:* the July guidance adapts the GloBE Rules in relation to tax credits that the originator can either use to satisfy its own income tax liability or sell to a third party. Those transferrable tax credits are treated as GloBE Income (irrespective of whether they are refundable) where they can be used by the holder of the credit (originator or purchaser) to reduce its tax liability and where they meet the "legal transferability standard" and "marketability standard". Where tax credits do not meet the criteria to be qualified refundable tax credits or marketable transferable tax credits, the guidance advised that these will be treated as reductions to the amount of covered taxes.

The July guidance further provides clarifications on qualified flow through tax benefits (QFTBs) including an alternative timing rule for when QFTBs reduce Covered Taxes for GloBE purposes.

- *SBIE guidance:* the July guidance provides further clarification on issues in relation to the SBIE, including the location of eligible employees and eligible tangible assets as well as the treatment of stock-based compensation, deductible dividend regimes, leases and impairment. As a simplification, the July guidance allows MNE groups to make a claim for some, but not all, of its eligible payroll costs and eligible tangible assets in the jurisdiction (i.e. rather than making the full SBIE calculation for the jurisdiction).
- *Guidance on currency conversion:* the July guidance confirms that MNE Groups are generally required to undertake GloBE calculations and report GloBE information for each jurisdiction in the presentation currency of the MNE Group's Consolidated Financial Statements (irrespective of the local currency of the relevant jurisdiction). Where amounts do not exist in presentation currency or because the amounts are translated at the aggregate level for GloBE computation purposes post accounting consolidation (i.e. not at the Constituent Entity level), the July guidance confirms that these amounts will need to be translated to the presentation currency specifically for GloBE computation purposes. In addition, the July guidance clarifies how to translate the amount of top-up tax liability into the currency in which the liability is payable and how to convert monetary thresholds that are expressed in a currency different from the CFS presentation currency.

According to the press release, the July guidance supplements the AG released in February (please refer to E-News Issue 170) and will be incorporated into a revised version of the Commentary that will be released later this year and will replace the original version of the Commentary issued in March 2022.

For more information, please refer to a dedicated KPMG report.

Release of model tax treaty provisions and related commentary for a Subject to Tax Rule (Pillar Two)

On July 17, 2023, the OECD/G20 Inclusive Framework (IF) on BEPS released model tax treaty provisions and related commentary for a Subject to Tax Rule (STTR) that can be used by jurisdictions to incorporate the STTR in their bilateral tax treaties. Where the STTR is included in a double tax treaty, the payment country will be permitted to charge additional tax on certain payments where those are subject to a nominal tax rate below 9 percent. Key elements include:

- *Nominal tax rate:* The nominal rate is the statutory tax rate that would generally apply on the respective in-scope payments, reduced by certain preferential tax adjustments that permanently reduce the amount of tax payable (e.g. exemptions or exclusions from income).
- *In-scope payments:* The STTR applies to certain types of payments between connected persons, including interest and royalty payments, payments for distribution rights, insurance or reinsurance premiums, financing fees, rent for the use of equipment, and payments for services. The concept of connected persons includes a 50 percent control test which provides that two parties are connected if both entities are under control of the same person either legally (directly or indirectly) or as a matter of fact and circumstance. There is also a specific anti-avoidance rule to prevent back-to-back arrangements involving intermediaries.
- *Thresholds and exceptions:* The tax under the STTR will be assessed annually following the end of each fiscal year and only applies where the total sum of covered income paid in a fiscal year exceeds EUR 1 million (EUR 250,000 if the size of the smaller of the payer or payee jurisdiction has a gross domestic product of less than EUR 40 billion). The STTR also does not apply where the income (other than interest and royalty income) is less than the costs attributable to the respective income plus a

mark-up of 8.5 percent (subject to certain qualifications) or where the payments involve individuals or certain defined types of entities.

- *Amount of tax charged and elimination of double taxation:* Under the STTR, the source country is allowed to impose an additional tax based on the gross amount of payments multiplied by the difference between the 9 percent STTR minimum rate and the adjusted nominal tax rate. Taxes imposed by the source country, (e.g. withholding taxes) will be credited against that additional tax liability. The recipient jurisdiction is neither required to provide an exemption or a credit for the tax payable under the STTR.

In terms of next steps, the OECD's Outcome Statement (dated July 12, 2023) noted that the STTR will be implemented via a multilateral instrument (MLI), which will be released in October 2023 along with accompanying explanatory notes. According to the statement, jurisdictions can elect to implement the STTR by signing the MLI, or bilaterally amending their treaties to include the STTR when requested by developing Inclusive Framework members.

For more information, please refer to a dedicated KPMG report.

OECD/G20 Inclusive Framework releases in respect of Pillar One

Amount A

On July 12, 2023, the OECD released an Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy. Key takeaways from an Amount A perspective include:

- The Inclusive Framework has delivered a text for the Multilateral Convention (MLC). A few jurisdictions have expressed concern on some issues and efforts are underway to resolve these issues with a view to prepare the MLC for signature expeditiously.
- The MLC will be open for signature in the second half of 2023 with a view to entering into force in 2025.
- Where at least 30 jurisdictions accounting for at least 60 percent of in-scope UPEs have agreed to the MLC, members of the Inclusive Framework have agreed to refrain from imposing newly enacted DSTs or relevant similar measures on any company between January 1, 2024 and the earlier of December 31, 2024 or date of entry into force of the MLC.

For more details, please refer to the OECD's release and KPMG's Tax News Flash.

Amount B

On July 17, 2023, the OECD issued a public consultation document seeking public comments on the design elements of Amount B under Pillar One. The document builds on and takes into account comments received in response to a prior consultation document released on December 8, 2022 (for previous coverage, please refer to E-News Issue 170). The work on Amount B is generally intended as a simplification and streamlining measure in applying the arm's length principle in relation to baseline marketing and distribution activities. A special focus shall be given to the needs of low-capacity jurisdictions in administering the application of the arm's length principle.

The new consultation document outlines the design elements of Amount B including the scoping criteria for qualifying baseline distribution activities, the selection of the appropriate pricing model under the

transactional net margin method for in-scope transactions and a pricing matrix based on three industry classifications and five bands of operating asset and operating expense intensity. It is noted, however, that the document does not represent the consensus view of all members of the Inclusive Framework and there are a number of significant outstanding issues, including the role of qualitative scope factors, the pricing framework, and the application of Amount B to the wholesale distribution of digital goods.

Public comments are requested by September 1, 2023. The IF aims to complete its remaining work in time for the final report on Amount B to be incorporated into the OECD Transfer Pricing Guidelines in January 2024.

For more details, please refer to the OECD's release and a dedicated KPMG report.

Local Law and Regulations

Croatia

Implementation of the EU Public CbyC Reporting Directive

On July 20, 2023, legislation to transpose the EU Public CbyC Reporting Directive into domestic law was published in the Official Gazette. Key takeaways include:

- The provisions of the Croatian bill are closely aligned with the text of the Directive.
- Croatia adopted the "safeguard clause", i.e. 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.
- Croatia opted for the website publication exemption.

For a state of play of the implementation of the EU Public CbyC Reporting Directive, please refer to KPMG's dedicated implementation tracker.

Germany

Draft business tax reform bill published

On July 14, 2023, the German Ministry of Finance published a ministerial draft tax reform bill to strengthen growth opportunities, investment and innovation as well as tax simplification and tax fairness (Growth Opportunities Act). Key takeaways include:

- *Reform of interest deduction limitation rule (ILR):* the draft proposes to convert the de minimis threshold of EUR 3 million into an allowance, i.e. only the net interest expenditure in excess of this amount is subject to the ILR. The allowance would be available on a group level rather than on an entity-by-entity basis (anti-fragmentation rule) and would not apply to interest carried forward from previous years. In addition, the draft proposes to abolish the stand-alone clause, the escape clause and the related regulations on external shareholder financing and to expand the definition of the term "interest" to align with the EU Anti-Tax Avoidance Directive (ATAD). The proposed ILR changes

would become effective from January 1, 2024.

- *Introduction of interest rate barrier rule:* the draft proposes to deny the deduction of interest expenses where they relate to intra-group interest payments that are subject to a rate that exceeds a legally defined maximum rate (a base rate as provided in the German Civil Code plus a 2 percent margin – for 2023, this would correspond to 3.62 percent). The deduction denial would not apply where evidence can be brought forward to prove that the creditor carries out substantial economic activity in his country of residence (motive test) or that both the creditor and ultimate parent company could only have received the capital at an interest rate higher than the maximum rate. The proposed rule would come into force on January 1, 2024.
- *Introduction of an investment premium*: the draft proposes to introduce a 15 percent investment premium in relation to the costs of investment in certain defined assets that serve to improve energy efficiency in the company. Eligible investments would be those made between the date the law becomes effective and January 1, 2028 (funding period). The premium would be limited at EUR 30 million per beneficiary for the entire funding period (i.e. the premium would apply to qualifying expenses of up to EUR 200 million per beneficiary). According to the explanatory memorandum, the premium would be treated as a contribution without affecting the company's profit or loss. For income tax purposes, the assets benefiting from the investment grant would be depreciated based on the acquisition/production costs reduced by the investment premium.
- *Expansion of R&D tax incentive:* the draft proposes to expand the existing research allowance by broadening the definition of qualifying expenses and increasing the annual amount of qualifying expenses from EUR 4 million to EUR 12 million for eligible expenses incurred after December 31, 2023. As such, the maximum annual allowance amount would increase from EUR 1 million to EUR 3 million based on an unchanged 25 percent allowance rate.
- *Amendments to tax loss deduction rules:* the draft proposes to increase the loss carryback period from two years to three years for losses incurred in 2024 or after. The increased maximum amount of EUR 10 million for a loss carryback (regularly EUR 1 million) would become permanent (currently limited to losses generated from 2020 to 2023). The current loss carry forward limitations (i.e. loss relief limited to EUR 1 million plus 60 percent of current income) would be temporarily suspended between 2024 and 2027. From 2028, the maximum loss relief amount would be increased from EUR 1 million to EUR 10 million, and the 60 percent limitation for exceeding current income would be reinstated. The amendments would apply for both corporate income tax and trade tax purposes.
- *Introduction of mandatory disclosure rules for domestic arrangements:* the draft proposes to expand the German mandatory disclosure rules for cross-border tax arrangements (DAC6) to cover also domestic arrangements. However, the scope of applicable hallmarks for domestic arrangements would be limited. The reporting obligation for domestic arrangements would generally be applicable from January 1, 2025. However, retroactive reporting may be required where the first step of a tax arrangement was implemented after the law has entered into force and before January 31, 2025.

The publication of the ministerial draft bill is the first step in the legislative process. This will be followed by the publication of the draft government bill, which will then be subject to approval by the Parliament and Federal Council. As such, amendments may still occur in the course of the legislative procedure.

For more information, please refer to a report prepared by KPMG in Germany.

Draft guidance on German CFC rules

On July 20, 2023, the German Ministry of Finance published draft guidance on the application of German CFC rules, as amended by the ATAD Implementation Act in 2021 (see E-News Issue 136 for reference). Some of the key clarifications include:

- *Catalogue of active income:* according to German CFC rules, any low-tax income is considered to be subject to the CFC rules if the income is derived through a type of activity that is not expressly defined as active. The draft guidance clarifies that a gain from the disposal of assets is considered as active income, to the extent the assets were used to generate active income. In addition, the draft guidance notes that individual activities with a significant economic impact are not to be grouped together but are to be assessed separately, even if they have an economic connection with other activities.
- *Motive test:* German CFC rules do not apply where taxpayers can demonstrate that at the level of an EU/EEA subsidiary a substantial economic activity is carried out with appropriate resources and by sufficiently qualified personnel, on an independent and autonomous basis. The draft guidance specifies the criteria of "substantial economic activity" and "material and personnel resources". In addition, the draft notes that the motive test is not met where the substantial economic activity is predominantly provided by third parties (e.g. based on business management contracts).
- *Low taxation:* the draft guidance further clarifies that a foreign company is not considered to be low taxed (i.e. effective tax rate of less than 25 percent) solely by the fact that its tax liability is settled by another company that belongs to the same tax group or consolidated group. The guidance further clarifies that where a foreign company generates low-taxed passive income and belongs to a tax group, the German CFC tax charge needs to be determined separately for this company.

Feedback by associations is requested by September 4, 2023. Notably, the draft guidance does not consider the proposal to amend German CFC rules in light of the envisaged Pillar Two implementation in Germany (for more information, please refer to E-News Issue 180).

For more information, please refer to a report prepared by KPMG in Germany.

Draft guidance on anti-hybrid mismatch rules published

On July 13, 2023, the German Ministry of Finance published draft guidance on the application of the German anti-hybrid rules. The anti-hybrid rules provide for a denial of the deduction of business expenses (in principle, incurred after December 31, 2019) to the extent a hybrid mismatch arrangement results in income being subject to non-taxation or a lower taxation in certain situations, a tax deduction in both states (double deduction) or a deduction in one state with simultaneous non-taxation in the other state (deduction/non-inclusion).

Key elements of the draft guidance include clarifications on:

- the temporal application of the rules;
- the term “hybrid financial instruments”;
- the concept of non-taxation and lower taxation;
- double deduction, deduction/non-inclusion and imported mismatch situations;
- structured arrangements that may trigger the non-deductibility of expenses even in respect of arrangements with third parties;

- the burden of proof and the taxpayer's duty to cooperate;
- priority of anti-hybrids rules over other deduction limitation rules.

Once finalized and published, the guidance would generally apply to all open cases. Feedback by associations is requested by August 10, 2023.

For more information, please refer to a report prepared by KPMG in Germany.

Hungary

Tax law amendments approved by Parliament

On July 14, 2023, Hungary published various amendments to the tax code in the Official Gazette, mostly effective from January 1, 2024. Key direct tax features include:

- Introduction of a temporary tax allowance where strategically significant investment for the purpose of transformation to a net-zero emission economy is made (including manufacturing equipment for batteries, solar panels, wind turbines, etc.). The taxpayer must apply for the allowance prior to commencing the investment. The allowance will be available until December 31, 2025 the latest.
- The time limit rule on the utilization of carry-forward tax losses generated up to the last day of the 2014 tax year will be cancelled; thus, these losses will be available for utilization without any time limit.
- The non-deductibility of certain advertising costs (currently qualifying as non-business-related expenses) will be abolished.
- The definition of permanent establishment will be extended. As such, (i) in the case of airlines, airports and the departure point of flights will be considered permanent establishments and (ii) a permanent establishment of temporary work agencies will be formulated, based on where the total number of hours worked in each municipality by the leased employees reaches at least 21,000 within the tax year is considered a permanent establishment.

For further information, please see a report prepared by KPMG in Hungary.

Ireland

Release of Feedback Statement regarding Pillar Two application

On July 27, 2023, the Irish Department of Finance released a Feedback Statement regarding the implementation of the OECD's Pillar Two Model Rules as set out under the EU Minimum Tax Directive (2022/2523). The Feedback Statement includes draft legislation that takes into account the OECD Commentary and elements of the GloBE Implementation Framework. Key features include:

- A QDMTT will apply for financial years starting after December 31, 2023.
- Provision for a QDMTT safe harbour rule in accordance with the EU Directive, which is not limited to EU Member States, but also applies to a QDMTT applied in non-EU countries.
- Provision for the transitional CbyC Reporting safe harbour and the simplified calculation for non-material constituent entities.

- A transitional UTPR safe harbour is included in line with the July 2023 Administrative Guidance which will apply for fiscal years which are no more than 12 months in duration that begin on or before December 31, 2025 and end before December 31, 2026. The UTPR Top-up Tax calculated for an UPE jurisdiction would be deemed to be zero if the UPE jurisdiction has a corporate income tax with a rate of at least 20 percent.
- To ensure consistency between domestic legislation and the Pillar Two rules is maintained as further guidance become available, it is proposed that specific reference to the OECD Model Rules, Commentary and Administrative Guidance will be made in the domestic legislation.
- Further feedback has been sought regarding the administrative provisions of the draft legislation, specifically seeking public comment regarding (i) the general approach that should be taken with regards to penalties, (ii) whether aspects of the current penalty regime should apply and (iii) whether a transitional penalty provision should apply.

Comments on the draft legislation are requested by August 21, 2023. For previous coverage, please see E-News Issue 174.

Feedback Statement on draft defensive measures on outbound payments

On July 7, 2023, the Irish Department of Finance published a Feedback Statement regarding potential new defensive measures which are to apply to outbound payments. The Feedback Statement outlines that the draft defensive measures may apply to certain payment of dividends, interest or royalties to certain entities from January 1, 2024. The proposed measures could apply to payments to entities located in jurisdictions on the EU list of non-cooperative jurisdictions, no-tax and zero tax jurisdictions.

The consultation period will end on August 8, 2023.

For more information, please refer to KPMG's summary of defensive measures applied by EU Member States against non-cooperative jurisdiction.

Technical guidance on DAC7 reporting obligations issued

On July 5, 2023, the Irish Revenue Commissioners published eBrief No. 155/23 regarding Tax and Duty Manual (TDM) Part 38-03-31 which relates to EU Reporting Obligations for Platform Operators. Key takeaways include:

- The TDM provides detailed technical guidance regarding reporting requirements for specific platform operators, as per Council Directive (EU) 2021/514 (also known as DAC7).
- From January 1, 2023, DAC7 obliges certain platform operators to collect and automatically report information on certain sellers using their platform to earn consideration.
- The DAC7 registration portal will open on October 1, 2023.

Lithuania

Amendments to the ownership conditions for reverse hybrid entities

On June 22, 2023, Law No. 2023-12400 was published in the Lithuanian Official Gazette introducing amendments to the ownership condition in the definition of reverse hybrid entities within the meaning of the EU Anti-Tax Avoidance Directive as amended (ATAD2).

The percentage ownership condition is now defined as 50 percent or more of shares, voting rights, rights to profit, etc. owned by an entity resident in a foreign jurisdiction that classifies the entity as a separate taxable person, but where Lithuanian tax law considers the entity as transparent for tax purposes.

The law entered into force on June 23, 2023.

Luxembourg

Launch of the legislative process to implement Pillar Two

On July 28, 2023, the Luxembourg government announced an intention to issue in the coming days a draft bill regarding the transposition of the OECD's Pillar Two Model Rules, as set out under the EU Minimum Tax Directive (2022/2523), into domestic law. The submission of the bill to Luxembourg's Chamber of Deputies will launch the legislative process. According to the press release, the draft legislation will provide for an IIR and an UTPR. The Ministry of Finance also signaled its intention to provide for a QDMTT.

Draft bill on investment tax credits

On July 13, 2023, the government of Luxembourg submitted a draft bill to the Parliament regarding an increase in the investment tax credit. Key features of include:

Introduction of a new investment tax credit for investments in digital transformation, and ecological and energy transition ("New ITC")

- The investment tax credit for "additional investment" would be repealed and replaced by a new tax credit for investments in digital transformation, and ecological and energy transition within businesses. The new ITC would not be calculated only on the acquisition cost of assets, but also on any qualifying deductible operating expenses.
- If the investment falls within the definition of digital transformation or ecological and energy transition, then such investment would be eligible to the extent it meets certain additional conditions with respect to (i) the type of asset, (ii) the type of expense, and (iii) the objective to be achieved (e.g. the implementation of a new production process aiming to substantially improve productivity or the energy efficiency).
- Projects must be submitted to the Minister of the Economy for certification regarding the eligibility of investments and operating expenses in the form of a certificate.

Amended tax credit for "global investment"

- The current tax credit for global investment remains in place and is subject to certain modifications. Most importantly, the bill introduces a single tax rate, by increasing the rate from eight percent to 12 percent and by repealing the EUR 150,000 bracket.
- The scope of the assets included has been updated to exclude software acquisitions falling within the scope of the New ITC from the scope of the tax credit for global investment. Any other software not acquired from a related enterprise remains eligible.

The bill will now go through the usual legislative process and may still be subject to further amendments. Due to the upcoming summer recess of the Parliament and the parliamentary elections in October, it remains

unclear when the bill will pass. Once approved, the new tax credit will enter into force as from the 2024 tax year.

For further information, please see a report prepared by KPMG in Luxembourg.

Implementation of the EU Public CbyC Reporting Directive

On July 19, 2023, the bill transposing the EU Public CbyC Reporting Directive into local legislation was approved by the Luxembourg Parliament. Key takeaways include:

- The provisions of the Luxembourg public CbyC bill are closely aligned with the text of the Directive.
- Adoption of the “safeguard clause”.
- Adoption of the website publication exemption.

Once published in the Official Gazette, the public disclosure rules will apply to financial years starting on or after June 22, 2024.

For a state of play of the implementation of the EU Public CbyC Reporting Directive, please refer to KPMG’s dedicated implementation tracker.

Poland

Solidarity contribution on coal companies

On July 10, 2023, the Polish government announced the release of a draft bill providing for the introduction of a solidarity contribution on taxable surplus profits generated by companies in the coal sector. Key elements include:

- the contribution would apply to companies that have derived more than 75 percent of their 2022 income from the extraction of coal or from the sale of coal products;
- the contribution would be levied at a rate of 33 percent on surplus profits generated in 2022;
- surplus profits would be calculated as the taxable profits that are above 20 percent of the average taxable profits of the preceding four years (i.e. 2018 to 2021).

Subject to approval by the Parliament and signature by the President, the bill would come into effect 14 days after being published in the Official Journal.

Turkey

Increased corporate income tax rate and abolishment of certain exemptions

On July 15, 2023, the Turkish government approved legislation regarding an increase in corporate income (CIT) tax rates for certain taxpayers. Specifically, (i) the basic corporate tax rate will increase to 25 percent (previously 20 percent), and (ii) the corporate tax rates imposed on banks, insurers, pension firms and other financial institutions will increase to 30 percent (previously 25 percent).

The legislation is deemed to be effective from the date of publication (i.e. from July 15, 2023). For previous coverage, please refer to E-News Issue 180.

Uganda

Uganda Approves Income Tax Amendments: Limits Loss Carryforward and Implements Digital Services Tax

On July 11, 2023, Uganda's Parliament approved changes to the Income Tax Act regarding loss making companies and digital services providers. Key takeaways include:

- if assessed losses have been carried forward for a period of seven years, taxpayers will only be able to claim relief for 50 percent of the losses carried forward in subsequent tax years;
- a digital services tax, with a rate of five percent, will apply to non-resident persons providing services in Uganda through digital platforms (e.g. online advertising, data services, digital content, online gaming, cloud computing, data warehousing, etc.).

The above provisions are effective from July 1, 2023. Please see a press release from the Ugandan Parliament for more information.

United Kingdom

Amendments to regulation on BEPS and CbyC Reporting

On July 5, 2023, the UK Treasury issued amended CbyC Reporting regulations The amendments provide that companies within the UK are no longer required to make an annual CbyC reporting notification stating which legal entity within the multinational enterprise is the ultimate parent entity and will be filing the CbyC report.

The amendments entered into force on July 26, 2023. For more information, please see a report prepared by KPMG in the UK.

Developments regarding Pillar Two legislation

Publication of draft UTPR legislation

On July 18, 2023, the UK government published draft legislation to amend the recently enacted Finance (No. 2) Act 2023. The amendments include the proposed adoption of the UTPR and other amendments to keep UK legislation consistent with the GloBE rules. Key takeaways include:

- the UTPR Top-up Tax would be collected in form of an additional Top-up Tax levied directly on UK constituent entities in an amount equal to the UTPR Top-up Tax amount allocated to the UK;
- the UTPR transitional safe harbour as detailed in the OECD's updated Administrative Guidance dated July 17, 2023 is not included;
- introduction of a non-material constituent entity safe harbour election which can be made on an entity-by-entity basis and can apply where an entity is not included in the consolidated financial statements on the grounds of size or materiality;
- a number of refinements to the enacted legislation, including the definition of 'Revenue' and the creation of a 'special foreign tax asset' where domestic losses have to be offset against foreign income that generates covered tax.

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

Royal Assent of Spring Finance Bill

On July 11, 2023, the Spring Finance Bill received Royal Assent. The Spring Finance Bill included the UK Pillar Two legislation regarding the implementation of an IIR and QDMTT. However, for UK GAAP and IFRS purposes, the Pillar Two legislation has been considered substantively enacted since June 20, 2023.

For previous coverage regarding same, please see E-News Issue 179 for reference.

Adoption of amendments to IAS 12

On July 19, 2023, the UK Endorsement Board (UKEB) announced that it has accepted amendments to IAS 12 Income Taxes, issued by the International Accounting Standards Board (IASB) in May 2023. The changes provide for the introduction of a temporary mandatory exception from accounting for deferred taxes arising from the Pillar Two model rules and a requirement to disclose that the exception has been applied, both of which are applicable immediately and retrospectively.

For more information regarding the amendments to IAS 12, please see a report prepared by KPMG International and a report prepared by KPMG in the UK.

Local Courts

France

The French Supreme Court holds that the French state is not in a comparable situation with other foreign states

On June 20, 2023, the French Supreme Administrative Court (Conseil d'Etat or the Court) ruled that, for the purposes of EU law, the France state is not in a comparable situation with other foreign states (Decision No. 463599).

The plaintiff was a French partnership owned by Kuwait, that realized capital gains from the sale of French immovable properties. Under French law, capital gains derived by foreign states were exempt from French capital gains tax. The partnership initially successfully claimed a refund of the capital gains tax, but following several proceedings on January 22, 2020, the Conseil d'Etat ruled that the exemption only applies to direct holdings. Therefore, in the Court's view, a partnership owned by a foreign state is not exempt from French tax, despite the foreign state itself being tax exempt.

The case was sent back to the lower court. During the new proceedings, the plaintiff noted that the partnership would have been exempt from capital gains tax had it been owned by the French state. The plaintiff therefore argued that the less favorable treatment of foreign states, as compared to the French state, constitutes a breach of the free movement of capital. The lower court ruled in favor of the plaintiff, but the tax authorities appealed the decision, and the case was brought again in front of the Conseil d'Etat.

The Court held that the French state and a foreign state were not in an objectively comparable situation. Therefore, in the Conseil d'Etat's view, the difference in treatment did not breach EU law.

Italy

SICAVs exempt from withholding tax on dividends distributed by Italian companies

On July 7, 2023, the first-level tax court of Pescara (the Court) held that a Luxembourg SICAV (Société d'investissement à Capital Variable) was entitled to a refund of withholding tax levied between 2009 and 2012 on dividends paid by Italian companies.

Under domestic law, Italian SICAVs were exempt from withholding tax, whereas foreign SICAVs were not. The legislation changed in 2021 to provide that dividends distributed by Italian companies and received by foreign undertakings for collective investment in transferable securities (UCITS) are entitled to the same favorable treatment previously available only to UCITS / SICAVs established in Italy.

In the judgment at hand, the Court also rejected the tax authorities' plea that the documents submitted by the taxpayer were insufficient to prove that the latter qualified as a UCITS within the meaning of EU law and was the beneficial owner of the dividends.

This decision is consistent with the ruling issued by the second-level tax court of Abruzzo on December 21, 2022 (see E-News Issue 172) and similar decisions issued by other Italian courts on February 7 and February 16, 2022 (for more information, please refer to E-News Issue 149).

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

Supreme Court decision on beneficial ownership of domestic interest payments

On February 28, 2023, the Italian Supreme Court (Supreme Court) issued two judgments (no. 6050 and 6079) dealing with the beneficial ownership concept in the context of interest payments.

The plaintiffs were two Italian subsidiaries that received a financing line from their direct shareholder, an Italian holding company (HoldCo). The latter was financed by a Luxembourg company (LuxCo), which held 45 percent of its share capital. Following a tax audit, the Italian tax authorities challenged the tax treatment applied by the plaintiffs in respect of interest payments performed to HoldCo. In the tax authorities' view, HoldCo was not the beneficial owner of the payments. Instead, in their view, the payments should have been treated as being received directly by LuxCo and should have been subject to Italian withholding tax. The tax authorities also took the view that the payments could not benefit from the withholding tax exemption under the Interest and Royalties Directive (IRD) since LuxCo was not a direct shareholder of the plaintiffs.

Referring to the so-called "Danish cases" (Joined cases C-115/16, C-118/16, C-119/16 and C-299/16) and the OECD Commentaries to the Model Tax Convention, the Supreme Court analyzed whether HoldCo could be deemed as the beneficial owner of the interest. First, the Supreme Court held that the initial burden of proof lies with the taxpayer, which is required to prove that the recipient is the beneficial owner of the payment – at a substantial and not merely at a formal level. Once this first step is passed, the burden of proof switches to the tax authorities, which must demonstrate the existence of an abuse of rights.

The Supreme Court continued by confirming that, in their view, a beneficial ownership investigation should be divided into three autonomous and distinct tests, as follows:

(i) the substantive business activity test, which aims to assess whether the intermediary company is an artificial construction;

(ii) the 'dominion' or control test, which is passed if the recipient is free to enjoy the income received and is under no obligation, whether through a contractual agreement or factual examination, to transfer the income to a third party. The Supreme Court identified several factors that could be relevant for the purpose of this test, including: the short time period between the moment the payments are received and when they are remitted to a third party; a small profit margin on the interest received; same individuals having a management role both in the intermediary company and the ultimate beneficiary; the entity that bears the risks of the loan.

(iii) the business purpose test, which investigates the reasons behind decision to divert the income stream. The aim of this test is to identify whether the payments were remitted to a third party due to commercial reasons or due to tax motives.

The Supreme Court then applied the tests above for the case at hand and concluded that LuxCo (and not the Italian HoldCo) was the beneficial owner of the payment. The Supreme Court also endorsed a look-through approach. However, in this specific case it upheld the assessment of the Italian tax authorities, based on which LuxCo could not benefit from the exemption under the IRD (since it did not meet the requirement to hold direct participation in the paying companies).

Supreme Court ruling on the subject-to-tax provision under the EU – Switzerland Savings Agreement

On June 6, 2023, the Italian Supreme Court (the Supreme Court) issued a decision in a case concerning the subject-to-tax provision under the EU – Switzerland Savings Agreement. The plaintiff was a Swiss company that received, between 2005 and 2007, royalty payments from its Italian subsidiary. The royalties were subject to a 5 percent withholding tax as per the double tax treaty concluded between Italy and Switzerland. However, under the EU – Switzerland Savings Agreement, royalty payments performed between associated companies are exempted from withholding tax, provided that "all companies are subject to corporation tax without being exempted in particular on interest and royalty payments".

The Swiss company filed a withholding tax refund claim based on the EU – Switzerland Savings Agreement. After a silent denial from the Italian tax authorities, the case was brought in front of two lower courts. These courts rejected the claim on the grounds that the plaintiff could not prove that tax was actually paid in Switzerland with respect to the royalty income received by the Swiss company. The plaintiff appealed the decision before the Supreme Court.

The Supreme Court noted that the EU – Switzerland Savings Agreement extends the provisions of the Parent Subsidiary Directive and the Interest and Royalties Directive to payments performed between an EU Member State and Switzerland. The Supreme Court continued by recalling that the case-law on the subject-to-tax matter evolved over time. In the Supreme Court's view, based on this case-law, the actual payment of tax on the same income, in the jurisdiction where the recipient is resident, is not relevant. Instead, the mere proof that the royalty income was included in the taxable base of the Swiss company was sufficient.

In light of the above, the Supreme Court upheld the plaintiff's appeal.

KPMG Insights

Public CbyC Reporting – are you ready to publicly disclose your data?

Following the adoption of the EU Public CbyC Reporting Directive, large multinational enterprises (MNEs) operating in the EU will soon be required to publicly disclose information related to their global operations, including on certain tax items. Disclosures will be required with respect to the entire group and irrespective of whether the parent entity is based in the EU or in a third country. In some instances, disclosures will be required as early as 2024, with respect to financial year 2023.

Against this backdrop, our webcast on August 1, 2023 focused on:

- a recap of disclosures required under the EU Public CbyC Reporting Directive and a state of play of implementation across the EU;
- what is known so far and likely direction of travel in terms of upcoming requirements in Australia;
- developments in the United States;
- the use of CbyC data for the purposes of Pillar Two;
- key challenges and practical insights on preparing for public CbyC reporting and beyond.

Please access the event page for a replay of the session.

Understanding the OECD's July Outcome Statement and other BEPS 2.0 developments

The Inclusive Framework has released or is expected to release material on a number of areas including:

Pillar One

- Outcome Statement on Amount A;
- Public consultation on 'Amount B' which deals with the simplification of transfer pricing rules for marketing and distribution,

Pillar Two

- Format of the GloBE Information Return;
- Foreign currency translation rules for GloBE;
- Design of Qualifying Domestic Minimum Top-up Tax rules and an accompanying Safe Harbour
- Operation of the Substance-based Income Exclusion
- Potentially a new transitional UTPR safe harbour,
- And the Subject to Tax Rule which deals with certain intragroup payments where the impact of treaties is to reduce the nominal corporate income tax rates to below 9 percent,

On July 26, 2023, a webcast brought together our leading global experts to speak about these developments and broader global landscape on the introduction of the GloBE rules.

Please access the event page for a replay of the session.

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