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E-News from the EU Tax Centre

Issue 188 – December 20, 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:** CJEU annuls Commission decisions on Luxembourg tax rulings related to intra-group license agreements and financing structures
- **CJEU:** CJEU referral on the Belgian 'fairness tax'
- **Council of the EU:** Pillar Two implementation in the EU – State of Play
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- **Zimbabwe:** Tax measures in 2024 budget
- **France (court decision):** Decision from French court on claims for foreign tax credit on dividends

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Latest CJEU, EFTA and ECHR

CJEU

CJEU annuls Commission decision on Luxembourg tax rulings related to intra-group license agreement

On December 14, 2023, the Court of Justice of the European Union (CJEU or the Court) gave its decision in case C-457/21 P. The case concerns the validity of a decision issued by the European Commission (EC), which found a transfer pricing ruling granted by the Luxembourg tax authorities in connection with an intra-group license agreement to be incompatible with EU State aid rules (the "Decision").

In the appeal brought before it, the CJEU concluded that the General Court wrongly recognized the arm's length principle as having general application within the context of the implementation of EU State aid rules. By relying on such principle, the EC incorrectly defined the reference system, the Court said. Finding that the selectivity analysis[1] was vitiated, the CJEU upheld the General Court's ruling of annulling the EC's Decision.

For additional details, please refer to Euro Tax Flash Issue 531.

CJEU annuls Commission decision on Luxembourg tax rulings related to intra-group financing structures

On December 5, 2023, the CJEU delivered its decision in the joined cases C-451/21 P and C-454/21 P. Both cases concern the validity of a decision issued by the EC (the "Decision"), which found two sets of tax rulings granted by the Luxembourg tax authorities in connection with intra-group financing structures to be incompatible with EU State aid rules.

The cases were first disputed in front of the General Court of the EU, which ruled in favour of the EC. In the appeal brought before it, the CJEU concluded that the General Court was wrong to confirm the EC's approach in determining the reference system. Finding that the selectivity analysis was vitiated, the CJEU decided to set aside the General Court's judgement and to annul the EC's Decision.

For additional details, please refer to Euro Tax Flash Issue 530.

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[1] It is settled CJEU case-law that the analysis of whether a national measure constitutes unlawful State aid requires several steps, including for the EC to demonstrate that the measure conferred a selective advantage on the beneficiary. For this purpose, the Commission is tasked with (i) identifying the reference system, i.e. the ordinary tax system applicable in that Member State in a factually comparable situation (by reference to the objectives of that regime), and (ii) demonstrating that the disputed tax measure – in this case the tax rulings – is a derogation from that 'normal' system.

Infringement Procedures and Court Referrals

CJEU Referrals

CJEU referral on the Belgian 'fairness tax'

On July 13, 2023, the Ghent Court of Appeal (the Court) made a referral (C-436/23) to the CJEU concerning the compatibility of the Belgian 'fairness tax' with the freedom of establishment laid down in Article 49 of the Treaty on the Functioning of the European Union (TFEU).

In 2013, Belgium introduced a 'fairness tax', that applied as a separate liability from corporate income tax, where the distributing company's profits were wholly or partially reduced through certain tax deductions. The taxable amount for the purposes of the 'fairness tax' was the positive difference between the gross dividends distributed and the distributing company's final taxable profits in the same taxable period, subject to certain adjustments. Both resident companies and permanent establishments (PEs) of foreign companies were in the scope of the tax.

Following an action for annulment filed by a taxpayer, the Belgian Constitutional Court asked the CJEU for a preliminary ruling on whether the application of the 'fairness tax' to non-resident companies with Belgian PEs breaches the freedom of establishment (case C-68/15). The CJEU ruled that it was for the referring court to ascertain whether the method of determining the taxable amount of 'fairness tax' puts a non-resident company with a Belgian PEs in a less advantageous position than a resident company – see Euro Tax Flash Issue 325. The Constitutional Court proceeded to annul in 2018 the fairness tax but maintained the effects of the annulled provisions for the assessment years 2014 to 2018.

The defendant in C-436/23 is a Belgian subsidiary of a car manufacturing group, which was liable to the 'fairness tax' in 2015 and 2016. The defendant challenged the tax liability and, following several proceedings, the case was brought in front of the Ghent Court of Appeal.

The Court noted that the 'fairness tax' must be disapplied for all assessment years in respect of non-resident companies with a Belgian PE on the grounds that such companies were treated less favourably than resident companies. However, disapplying these provisions would result in a difference in treatment between foreign companies with Belgian PEs and foreign companies with Belgian subsidiaries (which would remain in the scope of the tax for assessment years 2014 to 2018). The Court asked the CJEU whether this difference represented a restriction on the freedom of establishment.

EU Institutions

Council of the EU

Pillar Two implementation in the EU – State of Play

As previously reported, the EU Minimum Tax Directive entered into force on December 23, 2022 and requires Member States to transpose the rules into domestic law by December 31, 2023.

To the best of our knowledge, as at December 20, 2023, the state of play of the local implementation process across the EU can be summarized as follows:

- *Legislation fully enacted:* Denmark, Hungary, Ireland, Sweden.
- *Legislation approved by parliamentary bodies (subject to completion of further steps – e.g. presidential assent, publication in official journal for full enactment):* Austria, Belgium, Bulgaria, Czech Republic, Germany, Netherlands, Romania, Slovakia, Slovenia, Sweden.
- *Legislation submitted to and under review by national Parliaments:* Finland, France, Luxembourg.
- *Draft legislation published:* Croatia, Cyprus, Estonia, Italy, Latvia, Lithuania, Spain.
- *No (draft) legislation published:* Greece, Malta, Poland, Portugal.

In general, EU countries are required to apply the Income Inclusion Rule (IIR) for fiscal years beginning on or after December 31, 2023, with the Undertaxed Profits Rule (UTPR) to generally be applied for fiscal years beginning on or after December 31, 2024.

However, the Directive provides the option for Member States to defer the application of the IIR and the UTPR up to December 31, 2029, where a maximum number of 12 UPEs are based in that jurisdictions. According to a European Commission Notice, which was published in the EU Official Journal on December 12, 2023, five Member States, namely Estonia, Latvia Lithuania, Malta, and Slovakia will make use of the deferral option.

Most EU countries also intend to implement a Domestic Minimum Top-up Tax (DMTT) from 2024 – an exception might be Cyprus where the latest draft bill proposed a DMTT applicable from 2025.

For more details, please refer to KPMG's dedicated Pillar Two State of Play tracker.

European Parliament

Resolution on further reform of corporate taxation rules adopted

On December 12, 2023, Members of the European Parliament (MEPs) adopted a resolution on further reform of corporate taxation rules. The resolution proposes measures enhancing the competitiveness of European companies, with special emphasis on small- and medium-sized enterprises (SMEs), in the light of the current obstacles economies face.

Key takeaways include:

- *Reduction of compliance burden:* the resolution calls on the EC to carry out an EU-wide study to evaluate the compliance costs faced by businesses that operate in the EU with a view to launching an initiative to reduce high compliance costs and to reduce the administrative burden through enhanced cooperation . The resolution further calls on the EC to present an overall evaluation of previous actions in the area of corporate taxation since 2011 and to carry out competitiveness checks for new legislative proposals.
- *Tax incentives:* the resolution stresses that decisions on tax incentives should be taken by Member States in a coordinated manner with the aim to attract real investments. According to the resolution, such decisions should take into account concerns about an ageing society, decent labor and social standards, and the green and digital transitions. In particular, the resolution considers tax credits and permanent full expensing policies for capital investments. The resolution further

considers that tax certainty would be reinforced if Member States had a common understanding of what constitutes non-distortionary tax incentives and calls on the EC to evaluate the effectiveness of patent boxes and other intellectual property (IP) regimes.

- *Business in Europe: Framework for Income Taxation (BEFIT):* The resolution considers the BEFIT Directive proposal as a welcome opportunity to tackle the costs associated with tax compliance and to reduce the administrative burden, whilst helping to minimize aggressive tax planning. The resolution further calls on the EC to assess whether the introduction of a one-stop-shop requires further harmonization of the corporate tax base and the establishment of an allocation formula. In addition, the resolution recommends an assessment of whether the one-stop-shop could potentially be tested under Pillar Two before the new BEFIT rules are incorporated. The resolution also recommends that all very large firms operating in the EU should come within the scope of the future BEFIT proposal, whilst BEFIT should be kept optional for SMEs.
- *New own resources:* The resolution refers to the EC's proposal for a transitional statistics-based own resource linked to the corporate sector and notes that such measure, coherently conceived, should incentivize Member States to accelerate negotiations on BEFIT.
- *Debt equity bias reduction allowance (DEBRA):* the resolution invites the Council to reassess the DEBRA proposal and to potentially restart the examination of the proposal, which has been suspended since December 2022.
- *Other pending files:* The resolution invites the Council to continue, without further delay, negotiations on the European Commission's proposal to prevent the misuse of shell entities (Unshell) and also calls for a swift adoption and implementation of the proposal for a Faster and Safer Relief of Excess Withholding Taxes (FASTER).

Resolutions adopted by the European Parliament do not have a binding effect on the Council and the EC. However, those resolutions must be taken into account by the EC and Member States when proposing or agreeing to new rules.

On a related note, the report on the role of tax policy in times of crisis (see E-News Issue 186) was rejected in the Plenary vote. The report formed part of the ECON committee's attempts to address current challenges faced by European businesses through a revision of the EU's taxation rules.

OECD and other International Institutions and Research Centers

Organisation for Economic Cooperation and Development – OECD

Release of third tranche of Administrative Guidance (Pillar Two)

On December 18, 2023, the OECD/G20 Inclusive Framework (IF) on BEPS released a third tranche of agreed Administrative Guidance (AG) that aims to clarify the interpretation and application of several elements of the GloBE Rules, including:

- Clarifications on when purchase price accounting adjustments in Qualified Financial Statements ("QFS") do and do not need to be excluded from a MNE Group's Qualified Country-by-Country

(CbyC) Report.

- Further guidance on the Transitional CbyC Reporting Safe Harbour that addresses a variety of technical issues, including more details on the definition of QFSs, the computation of the Simplified ETR and routine profits test, and introduced new anti-avoidance rules to counteract concerns about hybrid arbitrage arrangements.
- Clarifications on the definition of revenue for the purpose of the EUR 750 million revenue threshold, and the treatment of mismatches between the fiscal year of the UPE and Constituent Entities ("CEs") and between the fiscal and tax years of CEs.
- Further Administrative Guidance on the allocation of Blended CFC Taxes that addresses the application of the allocation rules in various scenarios where a MNE Group is not required to compute its jurisdictional ETR under the full GloBE rules.
- Transitional Filing Deadlines for MNE Groups with Short Reporting Fiscal Years to ensure that groups with short fiscal years will not be required to file a Global Information Return ("GIR") until June 30, 2026.
- Simplified Calculation Safe Harbour for Non-Material Constituent Entities ("NMCEs") that provides a safe harbour similar to the Transitional CbyC Reporting Safe Harbour for NMCEs.

According to the press release, it is expected that the IF will release further agreed AG in the first half of 2024 on the application of deferred tax liability recapture rules and the allocation of deferred taxes relating to cross-border taxes such as CFC Tax Regimes. It is noted that the IF is also working on a peer review process, an administrative framework as well as dispute resolution mechanisms.

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

IF statement on extended Pillar One timeline

On December 18, 2023, the IF on BEPS further released an update on the work to finalize the Multilateral Convention to Implement Amount A of Pillar One (MLC).

The IF statement refers to the publication of the MLC text in October to ensure transparency, facilitate the ability of some members to engage in internal processes necessary for adoption, and facilitate resolution of remaining differences.

According to the IF statement, the work to resolve remaining differences will need to continue in 2024, including discussions on the standstill on new Digital Service Taxes. In addition, the statement reaffirms the IF members' commitment to achieve a consensus-based solution and to finalise the text of the MLC by the end of March 2024, with a view to hold a signing ceremony by the end of June 2024.

For previous coverage, please refer to E-News Issue 185.

2022 peer review report on the exchange of information on tax rulings (BEPS Action 5)

On December 14, 2022, the OECD issued the 2022 peer review report on compliance of Inclusive Framework members with the exchange of information on tax rulings under the BEPS Action 5 minimum standard.

The review covered 131 jurisdictions and included the following key findings:

- 100 jurisdictions are considered to fully comply with the standard;
- 31 jurisdictions received recommendations "to improve their legal or operational framework to identify the relevant tax rulings and exchange information";
- over 24,000 tax rulings in scope of the transparency framework have been identified between 2010 and end of 2022, with over 1,800 tax rulings being issued in 2022;
- more than 54,000 exchanges of information took place between 2010 and end of 2022.

For more information, please refer to the OECD press release.

Global Forum concludes 16th Plenary Meeting in Lisbon

From November 29 to December 1, 2023, the Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum) held its 16th Plenary Meeting in Lisbon (Portugal), which reunited over 420 participants from 115 jurisdictions and 13 international organizations. Key outcomes of the Plenary include:

- Publication of the latest Global Forum annual report, which provides information on the monitoring, peer-review, capacity building as well as outreach activities undertaken during the year.
- Publication of the Peer Review of the Automatic Exchange of Information (AEOI) 2023 update, which provides the latest conclusion of the peer reviews on the legal framework put in place by jurisdictions to implement the AEOI Standard. 123 jurisdictions are now committed to AEOI (including Armenia and Mongolia which are engaged to commencing exchanges by 2025 and 2026, respectively). As regards jurisdictions that are listed on Annex II of the EU list of non-cooperative jurisdictions with respect to criterion 1.1 (AEOI), the report notes that the legal frameworks of Aruba and Israel are now "*in place but need improvement*" while those of Costa Rica and Curaçao are still "*not in place*".
- According to the Global Forum press release, 62 percent of Global Forum members have now been fully reviewed in the second round of Exchange of Information on Request (EOIR) peer reviews and 88 percent of reviewed jurisdictions were rated "*Compliant*" or "*Largely compliant*".
- Six additional jurisdictions (Bermuda, Colombia, Faroe Islands, Indonesia, Mauritius and Monaco) joined the commitment previously made by 48 countries to implement the global transparency standard for crypto-assets by 2027 (please refer to E-News Issue 187).
- The Democratic Republic of the Congo and Fiji joined the Global Forum, bringing the total number of Global Forum members to 170.

For more details, please refer to the Statement of outcomes issued by the Global Forum.

OECD publishes Revenue Statistics 2023 Report

On December 6, 2023, the OECD published the latest annual Revenue Statistics report, which provides internationally comparative data on tax levels and tax structures in 36 OECD member countries for 2022 and all OECD member countries for previous years. Key takeaways from the OECD publication include:

- In 2022, tax-to-GDP ratios declined in 21 of the 36 countries for which preliminary data is available, rose in 14 countries and remained unchanged in one.

- Average tax-to-GDP ratio in the OECD fell by 0.15 percentage points in 2022, to 34 percent, following two years of increase during the COVID-19 crisis (0.15 percentage points in 2020 and 0.6 percentage points in 2021).
- Tax-to-GDP ratios for 2022 vary considerably between OECD countries, ranging from 16.9 percent (Mexico) to 46.1 percent (France).
- In most countries, revenues arising from corporate income tax increased as a share of GDP while revenues arising from excise taxes declined as a share of GDP. VAT revenues also declined as a share of GDP in 19 countries.
- 30 OECD countries have a higher tax-to-GDP ratio in 2022 that in 2010, with variations ranging from a decrease of 6 percentage points in Ireland to an increase of 9.6 percentage points in Korea.

For more details, please refer to the OECD press release.

OECD publishes a report raising awareness of dividend stripping schemes

On December 7, 2023, the OECD released a report on Dividend Stripping Schemes with the aim to raise awareness of dividend stripping frauds and provide a number of recommendations to tackle same.

According to the report, dividend stripping is a type of fraud that is committed through a complex mechanism of trading, selling and repurchasing shares over a certain period to unlawfully avoid payment of dividend taxes, or to claim unjustified tax reimbursements. Key recommendations to jurisdictions include:

- *raise awareness among relevant stakeholders:* provide tax administration and financial supervisory authorities with knowledge on dividend stripping schemes and their damaging effects, launch media campaigns about the risks and consequences of dividend stripping schemes aimed at the general public;
- *improve domestic coordination:* adapt legislation to prohibit dividend stripping schemes and criminalize the offence, establish mechanisms for sharing information between relevant authorities, create joint taskforces with a specific mandate for investigating dividend stripping schemes and foster cooperation between the different agencies;
- *expand international cooperation mechanisms:* establish the legal and operational framework for international cooperation, create common templates for foreign requests, create cross-border joint investigation teams and share good practices with international partners.

For more details, please refer to the OECD press release.

Local Law and Regulations

Belgium

Draft law proposes amendments to Belgian CFC rules

On December 12, 2023, the government submitted draft legislation to the Belgian Parliament proposing amendments to the Belgian Controlled Foreign Corporation (CFC) rules shifting from option B to option A under the EU Anti-Tax Avoidance Directive (2016/1164).

Whilst the current regime targets income arising from non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage, the new proposal provides for the taxation of non-distributed passive income subject to low taxation, as follows:

- *Participation requirement:* The taxpayer, alone or together with associated companies, has the majority of voting rights, at least 50 percent of the capital, or is entitled to at least 50 percent of the profits of a foreign company (a foreign PE automatically meets that condition).
- *Low taxation:* The qualifying foreign company or PE is not subject to income tax or is subject to income tax that is less than half of the corporate income tax that would have been due if the foreign entity would be a Belgian taxpayer. The condition is presumed to be met for entities established in jurisdictions on the EU list of non-cooperative jurisdictions or on the Belgian list of tax havens, but the presumption is rebuttable.
- *Passive income:* Passive income includes interest, royalties, dividends and income from the sale of shares, bonds, and options, rental income (including operational and financial leasing), income from asset management, investment, insurance, banking, and other financial activities, income from purchase and sale of goods and services with little value added. The CFC rules do not apply where passive income constitutes less than one-third of total income. Where the CFC belongs to the financial sector (as defined by the earnings stripping rules), the rules do not apply where less than one-third of the passive income comes from transactions with the Belgian taxpayer or its associated entities.
- *Substance exclusion:* An exception applies to income generated through substantial economic activity that is supported by personnel, equipment, assets and buildings (reference is made to the offering of goods or services on a market).

The new rules are expected to be approved before the end of 2023. According to the current draft law, the new CFC rules will become effective starting from assessment year 2024.

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

Draft law proposes changes to ‘Cayman Tax’ regime

On November 23, 2023, the government submitted draft legislation to the Belgian Parliament proposing changes to the “look-through” taxation of income from certain offshore legal constructions (the so-called ‘Cayman Tax’). Key changes include:

- The concept of chain arrangement’ would be supplemented by the concept of ‘intermediate arrangement’. As such, the ‘Cayman Tax’ would also apply to chains of legal structures in which

not all entities in the chain are legal structures.

- Amendments to the definition of 'founder' to broaden the scope to include those who hold the legal or economic rights of the shares "directly or indirectly" through a chain of intermediate structures.
- Application to structures that have been classified as a 'legal structure' in at least one of the three previous tax periods. This is to prevent a taxpayer from waiting to make a distribution until the taxable period in which the legal structure loses its qualification.
- Clarification of the term 'economic activity' in the context of the exemption based on proof that the legal structure has sufficient substance and thus engages in substantial economic activity.
- Amendments to the rules regarding tax-free capital gains
- An exit tax would be provided in cases when the founder moves their tax residence abroad.
- Extension of declaration requirements to be specified by a separate Royal Decree.

The amended 'Cayman Tax' would be effective for distributions and income obtained from legal structures from January 1, 2024.

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

Netherlands

Senate approved legislation to implement the EU Public CbyC Reporting Directive

On December 5, 2023, legislation implementing the Public CbyC Reporting Directive was approved by the Dutch Senate. Key takeaways of the approved legislation include:

- The provisions of the Dutch public CbyC bill are closely aligned with the text of the Directive.
- The bill provides for the possibility to apply 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.
- In-scope companies would be required to publish the reports on their website, as the Netherlands does not intend to grant an exemption from publication where the reports are made available free of charge on the website of the local commercial registry.
- EU-based branches of Multinational Enterprises (MNE) not governed by the law of an EU Member State must publish a group-wide report if the branch has a net turnover of EUR 12 million or more.
- The implementation of further guidelines will only require an order in Council.

The bill will become effective once signed by the King and published in the Official Gazette. The public disclosure rules will apply to financial years starting on or after June 22, 2024.

Saudi Arabia

Tax relief for companies having regional headquarters in Saudi Arabia announced

On December 5, 2023, the government of Saudi Arabia announced a tax incentive package to attract multinational groups to establish their regional headquarters (RHQ) in Saudi Arabia. Key measures include a zero percent corporate tax and zero percent withholding tax rate for 30 years on approved regional headquarter activities. The relief would be applicable from the date companies obtain their RHQ license.

In general, resident companies (in respect of the share of foreign residents), resident foreign nationals carrying on business activities and non-resident persons operating in Saudi Arabia through a PE are subject to a 20 percent income tax rate in Saudi Arabia.

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

Spain

Forms for new reporting obligations for digital platform operators (DAC7)

On November 23, 2023, the Spanish Ministry of Finance released a draft order to introduce new registration and reporting forms for digital platform operators to comply with the obligations under DAC7.

The draft order includes a form for purposes of registration, modification or deregistration of platform operators, a separate form to disclose the required information under DAC7 as well as clarifications regarding the relevant filing conditions and procedure.

Importantly, the effective application of the DAC7 rules is still pending approval of the draft reporting forms as well as the implementing regulations for the new reporting obligation. Nevertheless, it is expected that reporting platform operators will be required to submit the first information returns under DAC7 by January 1, 2024.

For more details, please refer to E-News Issue 178 and a report prepared by KPMG in Spain.

Zimbabwe

Tax measures in 2024 budget

On November 30, 2023, the government of Zimbabwe presented the 2024 national budget. Key direct tax proposals include:

- Increase of the corporate income tax rate to 25 percent (from 24 percent).
- Introduction of a domestic minimum top-up tax from 2024 with the aim of ensuring an effective level of taxation of 15 percent in response to the implementation of the Pillar Two GloBE rules.
- Introduction of a special 20 percent capital gains tax on the disposal/transfer of mining title/interest post January 1, 2024, subject to conditions.

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

Local Courts

France

Decision from French court on claims for foreign tax credit on dividends

On October 10, 2023, the Administrative Court of Appeal of Paris (the Court) issued a decision regarding claims for a foreign tax credit in relation to dividends received under the 95 percent participation-exemption regime, on the basis of two recent decisions from the French Administrative Supreme Court (Conseil d'Etat):

- a first decision issued on July 5, 2022, confirming that the 5 percent add-back under the French participation-exemption regime results in partial taxation of dividends received, opening the door for eligible taxpayers to obtain a partial tax credit in certain cases (see E-News Issue 158 for previous coverage); and
- a second decision issued on April 7, 2023, clarifying that the foreign tax credit cannot exceed the French corporate income tax amount due on the difference between (i) the 5 (or 1) percent add-back and (ii) the expenses incurred on acquiring or maintaining the dividend income (see E-News Issue 176 for previous coverage).

In the case at hand, two companies that were part of a tax consolidated group received in 2016 dividends from their foreign subsidiaries with 95 percent of the dividend income being tax-exempt. The company leading the tax consolidated group challenged the application of the 95 percent exemption and requested the application of the 99 percent exemption (i.e. that applies when stricter conditions are met). In the alternative, the plaintiff requested that the foreign tax credits corresponding to dividend withholding tax paid abroad are used to set off against the part of the dividend income that remained taxable (i.e., 5 percent of the amounts received).

The Court noted that the taxpayer merely produced a list – drawn up by itself for the purposes of the case – of the expenses incurred by the companies during the financial year. In the Court's view, the document submitted by the plaintiff was not sufficient to establish either the accuracy of the amounts listed therein, or the fact that they were incurred for the purpose of acquiring or maintaining the dividend income.

The Court therefore rejected the claim, stating that the plaintiff had failed to justify the amount of expenses actually incurred on acquiring or maintaining the dividend income.

Luxembourg

Administrative Appeal Court decides not to reclassify interest-free loan as equity

On November 23, 2023, the Administrative Appeal Court of Luxembourg ruled that an interest-free loan could not be reclassified as an equity contribution and that, under the arm's length principle, interest should be accrued in respect of the loan (for tax purposes).

The plaintiff was a Luxembourg subsidiary of a US group (LuxCo), which granted loans to other group entities. In 2016, its sole shareholder, also based in Luxembourg (Lux HoldCo), granted LuxCo an interest-free loan (IFL). This loan was financed through a profit participation loan granted by Lux HoldCo's sole shareholder, a Cayman company. LuxCo claimed that the arm's length principle, enshrined in article 56 of the Luxembourg Tax Code, required the recognition of interest, calculated using the cost-plus method, in relation to the loan granted between the two Luxembourg companies. The tax authorities challenged the deduction of the deemed interest at the level of LuxCo and argued that the IFL had to be reclassified into an equity contribution.

After an unsuccessful administrative procedure, LuxCo filed a petition with the Luxembourg Administrative Court in 2020, arguing that Luxembourg had granted to another company favourable rulings in a similar IFL case (currently under investigation for alleged unlawful State aid). The Company also argued that the Luxembourg tax authorities failed to demonstrate that the disputed transfer pricing methodology was vitiated by methodological errors. The Administrative Court did not discuss the transfer pricing methodology and agreed with the Luxembourg tax authorities that, based on the principle of substance over form, the IFL had to be reclassified into an equity contribution.

The decision was then appealed by LuxCo. The Appeal Court focused on the substance over form principle and the specific conditions of the IFL, including clauses for recourse in case of default, compensation for inadequate performance, and the loan-to-equity ratio (which included a non-existent interest rate). In this context the Appeal Court also noted that the intentions of the parties should not be assumed without proper consideration.

Upon reviewing the relevant loan terms, the Appeal Court thus determined that no specific condition of the IFL justified its recharacterization. The Appeal Court also considered that the Luxembourg tax authorities had not presented any rationale as to why the interest calculated by the taxpayer was not at an arm's length. In this regard, the Appeal Court observed that the interest income was recognized for tax purposes by Lux HoldCo. In light of the above, the Appeal Court ruled in favour of the plaintiff and allowed an interest deduction at the level of LuxCo.

KPMG Insights

Talking tax series

With tax-related issues rising up board level agendas and developing at pace, it’s more crucial than ever to stay informed of the developments and how they may impact your business.

With each new episode, KPMG Talking Tax delves into a specific topic of interest for tax leaders, breaking down complex concepts into insights you can use, all in under five minutes. Featuring Grant Wardell-Johnson, KPMG’s Global Head of Tax Policy, the bi-weekly releases are designed to keep you ahead of the curve, empowering you with the knowledge you need to make informed decisions in the ever-changing tax landscape.

Please access the dedicated KPMG webpage to explore a wide range of subjects to help you navigate the ever-evolving world of tax.

EU Tax Perspectives session

On December 13, 2023, KPMG held a new EU tax perspectives session as part of the Future of Tax & Legal webcast series.

The December edition of the webcast looked back on some of the highlights of the year and discuss the state of play of the various initiatives that are currently being implemented or considered by the EU Member States. The end of the year will also mark a change in the Presidency of the Council of the EU, with Belgium taking over from Spain from January 1, 2024.

A panel of KPMG specialists shared their insights on the current landscape and how it is expected to change in 2024, with a focus on:

- BEPS 2.0 in the EU: state of play on the implementation of the EU Minimum Tax Directive (Pillar Two), Pillar One developments and the future of digital service taxes
- EU harmonization and coordination initiatives: Business in Europe: Framework for Income Taxation (BEFIT), the Transfer Pricing Directive, the Withholding Tax Relief Framework (FASTER)
- Unshell (ATAD 3): state of play and possible timeline
- Other key EU initiatives: the October update of the EU list of non-cooperative jurisdictions, a possible review of the Directive on Administrative Cooperation, the Foreign Subsidies Regulation
- Looking ahead: the direction of EU tax policy in light of the upcoming European Parliament elections and the change in the Council's Presidency

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

Illustrative disclosures – Guide to annual financial statements

KPMG’s 2023 guides to annual financial statements are now available. They comprise Illustrative disclosures and a Disclosure checklist in accordance with IFRS Accounting Standards.

These updated guides reflect standards in issue at August 31, 2023 that are required to be applied by a company with an annual reporting period beginning on 1 January 2023.

In particular, they illustrate amendments to:

- IAS 12 Income Taxes relating to the initial recognition exemption and Pillar Two top-up taxes; and
- IAS 1 *Presentation of Financial Statements* relating to disclosure of material rather than significant accounting policies. Please also refer to our high-level visual guide for further guidance.

For more information, please refer to a dedicated KPMG web article.

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