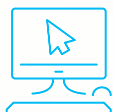
E-News from KPMG's EU Tax Centre

Key Insights of E-News Issue 204

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 referral:* New Romanian referral to the CJEU on the windfall taxation of energy producers
- *Council of the EU:* Council adopts the FASTER Directive
- *Council of the EU:* December 2024 ECOFIN report on tax issues released
- *European Commission:* Final public CbyC reporting forms published in the Official Journal
- *European Court of Auditors:* Report on the design and implementation of ATAD, DAC6 and TDRD
- *France:* New decree on Pillar Two filing and notification obligations
- *Hungary:* Legislative amendments and final registration form relating to Pillar Two law published
- *Netherlands:* New decree on OECD Amount B
- *Poland:* Minimum taxation rules (under Pillar Two) enacted
- *Italy (court decision):* Italian Supreme Court ruled on beneficial ownership status for reduced withholding tax on royalties



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Infringement Procedures and CJEU Referrals

Key Insights

- Italian Supreme Court refers case regarding Italian group regime to Court of Justice of the European Union
- New Romanian referral to the CJEU on the windfall taxation of energy producers

CJEU Referrals

CJEU referral on the compatibility of the Italian tax consolidation regime with EU law

On September 10, 2024, the Italian Supreme Court made a request for a preliminary ruling to the Court of Justice of the European Union (CJEU) (case C-592/24). The case concerns the compatibility of the Italian tax consolidation regime with EU law.

Until 2015, the Italian tax consolidation regime was limited to cases where the parent company was either a legal entity tax resident in Italy or a foreign entity with a permanent establishment (PE) in Italy, provided the PE held the shareholdings of each subsidiary in the consolidated group. However, following the CJEU's judgment in joined cases C-39/13 to C-41/13, Italy revised its tax consolidation rules in 2015 to bring it in line with the EU freedom of establishment. This amendment expanded the regime to include Italian tax-resident sister companies controlled by a parent company based in another EU Member State, regardless of whether the foreign parent had an Italian PE. For more information on the joined cases C-39/13 to C-41/13, please refer to Euro Tax Flash Issue 229.

The plaintiff in the case at hand was a French ultimate parent company that applied the Italian tax consolidation regime through its Italian branch. The plaintiff also held four Italian tax-resident subsidiaries that were not part of the consolidated group, since the shares in these entities were not attributable to the Italian branch. As a result, the subsidiaries could only deduct 96 percent of the interest they paid to the branch. Had the subsidiaries been included in the consolidated tax group, the interest expenses would have been fully deductible.

In 2015, the parent company filed a refund claim with the Italian tax authorities for the excess corporate income taxes paid by the subsidiaries from 2010 to 2012 due to this exclusion. Following several court proceedings, the case was brought in front of the Italian Supreme Court (Supreme Court).

The Supreme Court took the view that, based on the law applicable at that time, the restriction on the full deduction of interest expenses could infringe on the freedom of establishment and the equal treatment of companies within the EU. Therefore, the Supreme Court referred several questions to the CJEU for a preliminary ruling. These questions addressed whether the freedom of establishment, as interpreted by the CJEU in the joined cases C-39/13 to C-41/13, precludes national legislation:

- that denies access of certain companies to local tax consolidation regimes on the sole ground that their common parent company is resident in another Member State, whereas these companies could have benefited from this favorable tax system if their common parent company had been a tax resident in Italy or if the shareholdings in these companies had been attributed to an Italian PE of the non-resident parent company;

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- that only allows vertical tax consolidation between a resident parent company and its resident subsidiaries, and horizontal tax integration between subsidiaries of a non-resident company, whilst excluding tax consolidation between resident subsidiaries and a non-resident parent company;
- based on which the failure to opt for the tax consolidation in the corporate tax return (at a time when such consolidation was not permitted by national law), denies access to a reinstatement refund (by means of a refund) based on EU law.

New Romanian referral to the CJEU on the windfall taxation of energy producers

On July 1, 2024, the Bucharest Court of Appeal made a reference to the CJEU for a preliminary ruling regarding the compatibility of Romania's windfall taxation of energy producers with EU law (case C-462/24).

In November 2021, Romania introduced a windfall tax applicable to electricity producers. The tax has been amended and extended multiple times, and is currently effective until March 31, 2025. Fossil fuel-based electricity producers, including those using cogeneration, have been exempt from the windfall tax since the tax was first introduced. Beginning January 1, 2022, this exemption was extended to include biomass electricity producers.

The current case covers versions of the legislation applicable from April 1, 2022, to the end of 2023. The referring court has asked the CJEU to rule on several questions, including on whether:

- taxing only certain electricity producers, such as renewable energy producers, constitutes illegal State aid granted to energy producers not subject to the tax;
- imposing a discriminatory and excessive tax on certain electricity producers (e.g., renewable energy producers) breaches the freedom of establishment, the freedom to provide services, the free movement of capital, and the right to property enshrined in the Article 17 of the Charter of Fundamental Rights of the EU.

Four other cases involving different versions of the Romanian windfall tax are currently pending before the CJEU: C-391/23, C-251/24, C-261/24, and C-392/24.

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EU Institutions

Key Insights

- Council adopts the FASTER Directive
- December 2024 ECOFIN report on tax issues and non-legislative activities
- Final public CbyC reporting forms published in the Official Journal
- Initiative launched to provide standard DAC7 reporting forms for EU countries to share statistical data
- European Court of Auditors report on the design and implementation of ATAD, DAC6 and TDRD

Council of the EU

Council adopts the FASTER Directive

On December 10, 2024, the Council adopted the proposal on the Faster and Safer Tax Relief of Excess Withholding Taxes (FASTER) Directive. Key features of the FASTER Directive include:

- a common EU digital tax residence certificate, which will comprise of common content, regardless of the issuing Member State;
- two fast-track procedures complementing the existing standard refund procedure in each Member State, including: (i) a relief at source system, and (ii) a quick refund system. In-scope Member States will be required to implement one of the two systems (or a combination of both);
- the introduction of National Registers for financial intermediaries that will be able to facilitate the fast-track procedures. Such financial intermediaries will be subject to additional due diligence and common reporting requirements.

Please refer to Euro Tax Flash Issue 541 for more details on the FASTER Directive.

The adoption represents the last step in the adoption process and the FASTER Directive will now be published in the EU Official Journal. The rules will become applicable as of January 1, 2030.

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

December 2024 ECOFIN report on tax issues released

On December 10, 2024, the ECOFIN Council approved a report to the European Council providing an overview of the progress achieved during the term of the Hungarian Presidency.

Key takeaways from a direct tax perspective include:

- *FASTER Directive:* The report notes that the Directive to introduce safer and more efficient withholding tax procedures was formally adopted by the Council on December 10, 2024. According to the report, this follows the ECOFIN Council's agreement on the general approach in May 2024 and the subsequent adoption by the European Parliament (i.e., non-binding opinion on the final text). For previous coverage, please refer to E-News Issue 203.

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- *Unshell Directive proposal:* With respect to the Directive proposal on preventing the misuse of shell entities for tax purposes, the report notes that the Hungarian Presidency presented a new approach and drafting suggestions concerning scope, hallmarks and reporting obligations. According to the report, delegations in the Council working groups requested further clarification regarding the relationship of the proposal with the Directive on Administrative Cooperation (DAC) and stressed the need to avoid excessive administrative burden for business and authorities.
- *Transfer Pricing Directive proposal:* With respect to the Transfer Pricing Directive proposal, the report notes that the majority of EU countries do not see the possibility of further progress on the proposal in its current form. According to the report, Member States discussed in parallel the option of establishing a new EU Transfer Pricing Platform, its institutional set-up, structure, mandate, governance and voting rules. The report notes that such a platform would be established outside the framework of a Council Directive and would be aimed at determining consensus-based non-legally binding solutions to practical transfer pricing issues. According to the report, further work would be required on such a "*soft law*" approach subject to the requirements of Article 296(3) of the Treaty on the Functioning of the European Union (TFEU)[1].
- *BEFIT Directive proposal:* The report notes that the Directive proposal on a common EU corporate tax framework has been subject to discussions in the Council working groups under the Hungarian Presidency. According to the report, discussions specifically focused on the proposed rules on tax depreciation, timing and quantification, aggregation and allocation of the BEFIT tax base, the "traffic light" system, and administrative provisions. In addition, the report notes that further reflection and technical work will be required with a preference expressed by several Member States for giving priority to certain elements of the proposal, as a way forward.
- *Head Office Tax (HOT) System Directive proposal:* Issued in September 2023, the HOT Directive proposal would allow certain EU-based standalone SMEs operating in other Member States only through permanent establishments (PEs) to make a five-year election to determine the taxable results of the PEs according to the rules of the Member State of their head office. However, according to the report, the proposal cannot be supported by Member States due to a number of fundamental concerns, which were not elaborated on in the report. The report notes that the Hungarian Presidency was not able to resolve the concerns by suggestions to reduce the scope of the Directive proposal. The report further states that Member States discussed in parallel the need for a broader analysis of measures to support SMEs that would go beyond taxation measures.
- *DAC9 proposal:* With respect to the proposal for a Directive establishing a framework for the exchange of information required under the EU Minimum Tax Directive (DAC9), the report notes that following its release on October 28, 2024, an initial exchange of views was held in a Council working group on November 13, 2024. According to the report, the proposal is considered a priority file and requires further technical work for it to proceed quickly.
- *Exchange of financial information*: Following the Council's adoption in May 2024 of a Decision authorizing the opening of negotiations for the amendment of the agreements concerning the automatic exchange of financial account information to improve international tax compliance between the EU and the Swiss Confederation, the Principality of Liechtenstein, the Principality of Andorra, the Principality of Monaco and the Republic of San Marino, respectively, the European Commission opened negotiations with the five jurisdictions. The report notes that the goals of the negotiations also include the alignment of the agreements with the updated Common Reporting Standard (CRS), as implemented in the EU as part of DAC8.

For more information on the different ongoing EU direct tax initiatives, please refer to Euro Tax Flash Issue 543.

ECOFIN update on non-legislative activities

The report approved by the ECOFIN Council on December 10, 2024, also contains updates on non-legislative activities.

Key takeaways include:

[1] Article 296(3) TFEU: When considering draft legislative acts, the European Parliament and the Council shall refrain from adopting acts not provided for by the relevant legislative procedure in the area in question.

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- *UN tax cooperation:* the report notes that the EU Member States abstained from voting on the UN resolution on the "Promotion of inclusive and effective international tax cooperation at the United Nations" on November 27, 2024 - please refer to the "OECD and other International Organisations" section below for further details. The report makes reference to the common EU position approved by the European Council on October 8, 2024, which outlines key points of concern that EU countries have in relation to the terms of reference for a framework convention on international tax cooperation. Based on the EU position paper, EU countries prefer a consensus-based decision-making process and take the view that the terms of reference do not adequately reflect the principle of complementarity with the existing and ongoing work on international tax cooperation being carried out in other fora.
- *Draghi report:* the ECOFIN report makes reference to the report on "The future of European competitiveness" prepared by Mario Draghi at the request of the European Commission. According to the ECOFIN report, the "Draghi report" was discussed in several Council configurations with a focus on how decluttering and simplification of EU tax legislation may contribute to more competitiveness while preserving the effectiveness of measures for the prevention of tax fraud and aggressive tax planning. In addition, the ECOFIN report notes that some Ministers reflected on how tax incentives may support innovation, research and development, and digitalisation. Finally, the ECOFIN report notes that Mr. Draghi's recommendation to extend qualified majority voting to the area of taxation was opposed by a large number of Member States that prefer to maintain the current unanimity voting approach.
- *CoCG work on EU preferential tax regimes:* according to the Code of Conduct Group (CoCG or Group) report to the Council, the Group agreed to consider Portugal's tax incentive scheme for the capitalisation of companies as not being harmful. In addition, with respect to Croatia's investment promotion act, the report notes that the Group decided to await the final review by the Forum on Harmful Tax Practices and the formal adoption of the rollback measure in Croatia. For more information on the Group's standstill and rollback review process, please refer to Euro Tax Flash Issue 542.
- *CoCG work on EU listing exercise:* the Group's report notes that the CoCG will continue to assess compliance with criterion 1.2 (exchange of information on request - EOIR) on the basis of the overall ratings on EOIR issued by the Global Forum. As such, the Group will take into account the new framework for the Global Forum peer review process (applicable from 2025) and incorporate into its assessment recommendations addressed by the Global Forum in enhanced monitoring reports. With respect to criterion 2.2 (facilitation of offshore structures), the report notes that three jurisdictions[2] were informed about the need to address soft recommendations in relation to substance requirements for Collective Investment Funds in preparation for the CoCG review in 2025. The report further notes that the CoCG will broaden the scope of its review of criterion 3.2 (implementation of the non-public CbyC Reporting minimum standard) from 2025. According to the report, this will include jurisdictions with one or more outstanding general recommendations in the 2024 Inclusive Framework peer review report and one or more resident Ultimate Parent Entities (UPEs) in 2022 or 2023. Finally, the report notes that the latest EU screening exercise found New Zealand compliant with all the listing criteria whilst the screenings for Brunei Darussalam and Kuwait are still ongoing.

European Commission

Final public CbyC reporting forms published in the Official Journal

On December 2, 2024, the Commission's Implementing Regulation laying down a common template and electronic reporting formats (Regulation) for the application of the EU Public Country-by-Country (CbyC) Reporting Directive (Directive)[3] was published in the Official Journal of the EU.

The final version of the Regulation is in line with the updated Regulation and reporting forms previously published by the Commission.

The Regulation will come into force on the twentieth day after its publication in the Official Journal, i.e., on December, 22, 2024. As previously reported – see E-News Issue 203, the Regulation will apply to CbyC reports prepared for financial years starting on or after January 1, 2025.

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[2] The Bahamas, British Virgin Islands and Cayman Islands.

[3] European Commission's Implementing Regulation 2024/2952 from November 29, 2024.

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For more information on public CbyC Reporting, please refer to KPMG's dedicated webpage.

Initiative launched to provide standard DAC7 reporting forms for EU countries to share statistical data

On November 18, 2024, the European Commission announced an initiative to provide standard forms and computerized formats for the exchange of statistical data between EU countries in relation to the Council Directive (EU) 2021/514 (DAC7). According to the Commission's "Have your say" website, the intention is for the EC to adopt an implementing regulation that will specify:

- the date by when Member States have to submit statistical data in relation to information reported by digital platform operators;
- the kind of statistics to be provided in relation to joint audits.

A draft act will be published for feedback from stakeholders (timeline unknown) and Commission adoption is planned for the first quarter 2025.

For more information on DAC7, please refer to Euro Tax Flash Issue 543.

European Court of Auditors

Report on the design and implementation of ATAD, DAC6 and TDRD

On November 28, 2024, the European Court of Auditors (ECA) published a report on "Combatting harmful tax regimes and corporate tax avoidance".

The report assesses the appropriateness of measures and mechanisms employed by both the European Commission and selected EU Member States[4] with a focus on the design and implementation of the Anti-Tax Avoidance Directive (ATAD), Council Directive (EU) 2018/822 amending Directive 2011/16/EU (DAC6) and the Directive on Tax Dispute Resolution Mechanisms (TDRD) between 2019 and 2023.

Key findings and recommendations from the ECA include:

- *Inconsistent interpretation and application of EU legislation:* the report finds that certain definitions and terms in the EU legislation under review are posing interpretative challenges for EU countries. For example, with respect to DAC6 implementation, the report identifies different interpretations with respect to a number of hallmarks (A3, B2, B3 and C1), the main benefit test and other Directive terms. As a result, the report calls on the European Commission to develop guidelines by the end of 2026 on interpreting the respective EU legislation with a view to ensure consistent application by EU countries.
- *Limited use of DAC6 information:* the report notes that between mid-2020 and the end of 2023, EU Member States have submitted over 53,000 reportable cross-border arrangements to the EU central directory. However, the ECA finds that there is only a limited use of the disclosed DAC6 information by the Member States in scope. According to the report, the majority of audited EU countries did not carry out systematic risk analyses using the information available in the EU central directory, but instead used it on an ad hoc basis, at the request of tax inspectors.
- *Quantity and quality of DAC6 reports:* the report identifies a risk that the arrangements reported in the EU central directory may be incomplete or inaccurate (e.g., due to diverging interpretations of the DAC6 provisions and inadequate quality checks by tax administrations). In this context, the ECA finds that Member States engage in few data quality checks in relation to the DAC6 information reported and subsequently submitted into the EU register,

[4] The ECA audited five EU Member States (Ireland, Cyprus, Luxembourg, Malta and the Netherlands), which were selected on the basis of quantitative and qualitative risk criteria.

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and found little evidence of the Member States in scope performing or planning to perform checks on reporting procedures and processes of intermediaries. In addition, the report highlights issues for EU countries to identify non-EU countries involved in cross-border arrangements. As a result, the report recommends including in the reporting schema a mandatory data field for non-EU countries involved in cross-border arrangements by the end of 2027.

- *Impact of penalties:* the report further identifies a risk that local penalty systems for non-compliance with the DAC6 reporting obligations may not have a dissuasive effect. In this context, the report notes that the EU countries audited provide for low levels of penalties and have not yet imposed any. As a result, the report calls on the European Commission to initiate infringement proceedings by the end of 2026 in those cases where there is sufficient evidence that EU countries are implementing a manifestly inadequate penalty system for non-compliance with DAC6.

In addition, the report focuses on the impact of the work of the Code of Conduct Group (Business Taxation) with respect to the EU's efforts to combat harmful tax regimes. In this respect, the report calls on the European Commission to enhance its support to the Code of Conduct Group (e.g., by proposing clear rules and limitations on grandfathering and rollback periods) and criticizes the fact that EU Member States can choose to apply only a limited number of defensive measures against non-cooperative countries.

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OECD and other International Organisations

Key Insights

- G20 Rio de Janeiro leaders' declaration published
- UN Second Committee approves terms of reference for framework convention on international tax cooperation

OECD

G20 Rio de Janeiro leaders' declaration published

On November 18, 2024, the G20 leaders issued a declaration following their meeting in Rio de Janeiro. Key takeaways from a direct tax perspective include:

- *Taxation of high-net worth individuals*: the declaration includes a commitment to ensure cooperatively the effective taxation of ultra-high-net-worth individuals. According to the declaration, the cooperation could involve exchanging best practices, encouraging debates around tax principles, and developing anti-avoidance mechanisms, including addressing potentially harmful tax practices. The declaration further encourages the Inclusive Framework on BEPS to consider working on these issues.
- *BEPS*: the declaration reiterates the group's commitment to the swift implementation of the Inclusive Framework two-pillar solution, including expeditious negotiations on the final package of Pillar One.
- *UN tax cooperation:* according to the declaration, the G20 continue constructive discussion at the United Nations on the development of a Framework Convention on International Tax Cooperation and its protocols.

For previous coverage on the OECD Secretary General report to the G20 Finance Ministers and Central Bank Governors, please refer to E-News Issue 202.

United Nations

UN Second Committee approves terms of reference for framework convention on international tax cooperation

On November 27, 2024, the United Nation's Economic and Social Committee (Second Committee) adopted a resolution that approves the terms of reference for a framework convention on international tax cooperation, with 125 countries in favor, nine against and 46 abstentions.

The voting results reflected a similar pattern to the voting in the Ad-Hoc Committee, in which the majority of countries in Africa, Latin America, the Caribbean and Southeast Asia voted in favor, whilst EU Member States abstained from voting and other OECD members opposed the resolution, including Australia, Canada, Japan, New Zealand, South Korea, the United Kingdom and the United States.

According to the resolution, an intergovernmental negotiating committee will develop the framework convention and is expected to meet in 2025, 2026 and 2027 for at least three substantive sessions per year. The resolution requests the

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committee to complete its work and submit the final text of the framework convention to the General Assembly for approval by September 2027.

As a next step, the UN's General Assembly will need to approve a budget fur such negotiations.

For previous coverage, please refer to E-News Issue 200.

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Local Law and Regulations

Key Insights

- Guernsey, Isle of Man and Poland enact Pillar Two rules
- Gibraltar and Spain proceed with the implementation of Pillar Two
- France and Hungary clarify Pillar Two registration and filing requirements
- Austria, Germany and Slovakia proceed with incorporating additional OECD Pillar Two Administrative Guidance
- The Netherlands publish new decree on their position on OECD Amount B (under Pillar One)
- Denmark, Norway and Slovakia publish proposals to implement DAC8 / reporting obligations for crypto-asset service providers
- Poland publishes proposed update of national list of tax haven jurisdictions
- Poland publishes two general rulings on the requirement of effective taxation for WHT purposes
- Italy publishes guidelines on the Italian PE exemption for investment management
- Germany, Ireland and Slovenia gazette various direct tax amendments

Austria

Regulation published on transitional CbyC Reporting Safe Harbour under Pillar Two

On December 5, 2024, a regulation was published in the Austrian Official Gazette implementing several aspects of the transitional CbyC Reporting Safe Harbour that were agreed as part of the OECD December 2023 Administrative Guidance. Key takeaways include:

- *Qualified Financial Statements*: the regulation requires the data relevant for the Safe Harbour tests to be derived from a consistent source for a constituent entity or permanent establishment (i.e., from the reporting package used to prepare the Consolidated Financial Statement or from the local statutory accounts). The regulation further requires that the chosen source of data is used consistently for all entities in a tested jurisdiction, with exceptions for non-material constituent entities and permanent establishments.
- *Treatment of purchase price accounting:* the regulation clarifies when purchase price accounting adjustments do and do not need to be excluded from a group's Qualified CbyC Report.
- *Hybrid arbitrage arrangements:* the regulation requires adjustments to the tested jurisdiction's profit before tax and tax expense for certain types of hybrid arbitrage arrangements that are entered into after December 15, 2022.

The regulation is applicable for financial years starting on or after December 31, 2023.

For more information on the December 2023 Administrative Guidance, please refer to a report prepared by KPMG International.

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Denmark

Consultation launched on implementation of DAC8

On November 18, 2024, the Danish Ministry of Taxation launched a consultation on a draft bill to transpose Council Directive (EU) 2023/2226 (DAC8) into domestic law. Key takeaways include:

- In accordance with DAC8, the bill would introduce rules on due diligence procedures and reporting requirements for crypto-asset service providers and platforms. In-scope crypto-asset service providers would be required to collect and verify information from EU clients, in line with specific due diligence procedures. Subsequently, certain information would be reported to the relevant competent authorities in Denmark. This information would then be exchanged by the tax authorities of Denmark with the tax authorities of the Member State where the reportable user is tax resident.
- As required under DAC8, the bill would expand the scope of the automatic exchange of advanced cross-border rulings to also include rulings issued to individuals (DAC3).
- In accordance with DAC8, the bill also provides for amendments the reporting obligations in respect of cross-border arrangements (DAC6). This includes changes to the notification requirements for intermediaries bound by legal professional privilege and amendments to the information reportable under DAC6.

The amendments are proposed to take effect on May 1, 2025.

The deadline for submitting feedback to the public consultation is December 13, 2024.

For more information about DAC8, please refer to Euro Tax Flash Issue 543.

France

New decree on Pillar Two filing and notification obligations

On December 5, 2024, a new decree specifying the filing and notification obligations for entities within the scope of the French Pillar Two law was published in the Official Gazette.

Key highlights include:

- *Additional disclosures in the local corporate income tax (CIT) return:* The decree provides that local constituent entities must indicate in their CIT return whether they are filing a self-assessment notification ("relevé de liquidation") for Pillar Two purposes. In cases where the group will opt for a designated filing entity, the name of the designated constituent entity filing the self-assessment notification ("relevé de liquidation") must be provided. This information is to be included in the CIT return, along with the information that it belongs to an in-scope group. This includes information on the identity of the UPE/the Designated Filing Entity filing the GIR, if applicable, and the jurisdictions they are located in. The CIT return is to be filed within 4.5 months after the end of the fiscal year.
- *Content of the GloBE Information Return (GIR) and the self-assessment notification ("relevé de liquidation"):* The decree outlines the required content for both the GIR, which follows the outline as presented in the Annex of DAC9, and the content of the self-assessment notification ("relevé de liquidation"). The decree also clarifies that entities that are not subject to top-up tax or where the top-up tax liability is paid by a designated entity, are exempt from submitting the self-assessment notification ("relevé de liquidation"). Additionally, it specifies the information to be provided for jurisdictions benefitting from the transitional CbyC Reporting Safe Harbour.
- *Exchange of information of the GIR:* the decree outlines the details on the exchange of information with other jurisdiction and notes that jurisdictions would only receive the parts of the GIR that are relevant for them based on their role within the MNE group. The decree notes that a ministerial order will be published, listing the jurisdictions that have adopted a qualified Domestic Minimum Top-up Tax (DMTT), Income Inclusion Rule (IIR), and Undertaxed Profits Rule (UTPR), and have entered into an information exchange agreement with France.

For more information, please refer to a report (in French) prepared by KPMG in France.

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Germany

Revised draft law proposing amendments to Pillar Two law

On December 6, 2024, the German Ministry of Finance launched a consultation on a revised discussion draft proposing further amendments to the German Minimum Tax Act.

Key takeaways include:

- *Safe Harbour:* the draft proposes changes to the local implementation of the transitional CbyC Reporting Safe Harbour to incorporate the OECD December 2023 Administrative Guidance (including anti-hybrid arbitrage rules that would apply to transactions entered into after December 15, 2022, and clarifications on the treatment of purchase price accounting for the purposes of qualifying for the CbyC Reporting Safe Harbour).
- *Divergences between GloBE and accounting carrying values:* the draft includes the OECD June 2024 Administrative Guidance clarifications for determining the deferred tax expense for GloBE purposes when the rules result in divergences between GloBE and accounting carrying value of assets and liabilities.
- *Recapture of deferred tax liabilities (DTLs):* the draft also includes the OECD June 2024 Administrative Guidance provisions on the possibility to aggregate DTL categories and methodologies for determining whether a DTL reversed within five years.
- *Filing deadlines:* the draft clarifies that the first GIR filing deadline will be no earlier than June 30, 2026 (e.g., also for groups with short fiscal years ending before December 31, 2024).

For more information, please refer to reports by KPMG International on the December 2023 Administrative Guidance and the June 2024 Administrative Guidance.

The amendments would generally apply for financial years starting on or after December 31, 2023. An exception applies with respect to the anti-hybrid arbitrage rules in the context of the transitional CbyC Reporting Safe Harbour, which would apply for financial years starting after December 31, 2024.

In addition, the draft proposes measures aimed at simplifying existing German anti-abuse measures. This includes the proposed removal of the German royalty deduction limitation rules from 2025 and the removal of the extended CFC rules for capital investment income (currently providing for a lower participation threshold of at least 1 percent) with retroactive effect from 2022.

The deadline for submitting feedback to the public consultation is January 31, 2025.

Note that it remains to be seen to what extent the proposed measures will be included in a subsequent ministerial or government draft bill. Please also note that following the end of the German governing coalition new elections are scheduled for February 2025. Especially for legislative projects at an early stage, for which e.g., a discussion draft or draft bill of the Federal Ministry of Finance has been submitted, there may be delays in the further proceedings or even termination as a result.

Annual Tax Act 2024 enacted

On December 5, 2024, the Annual Tax Act 2024 was published in the German Official Gazette. Key measures include amendments to Pillar Two, CFC taxation and withholding tax relief procedure in line with the version adopted by the Parliament on October 18, 2024.

For more details, please see E-News Issue 202 as well as report prepared by KPMG in Germany.

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Gibraltar

Draft Pillar Two legislation published

On December 10, 2024, Gibraltar published the draft Global Minimum Tax Bill 2024, to incorporate Pillar Two rules into domestic law and the bill confirms the minimum rate for the purposes of the top-up tax is 15 percent.   .

Key features include:

- *DMTT:* The bill introduces a DMTT that would apply to MNE groups and domestic groups meeting the revenue threshold for financial years starting on or after December 31, 2023. The DMTT generally follows the OECD Model Rules and related DMTT guidance for determining the ETR and Top-up Tax liability. However, the DMTT would be imposed with respect to 100 percent of the Top-up Tax calculated for local constituent entities (i.e., it cannot be limited to the UPE's ownership percentage in the local constituent entities). Cross-border taxes, such as CFC taxes that would be allocated to domestic constituent entities under the regular GloBE rules, need to be excluded for DMTT purposes. In addition, the bill requires for the DMTT to be determined based on information from financial statements prepared in accordance with the UPE's Financial Accounting Standard, except where it is not reasonably practicable to use such accounts. Investment entities and insurance investment entities are excluded from the scope.
- *IIR:* The bill also introduces an IIR that would apply for financial years starting on or after December 31, 2024. As is the case for the DMTT, the IIR is closely aligned with the OECD Model Rules.
- *OECD guidance:* The bill incorporates a general reference to the OECD Model Rules, OECD Commentary, Administrative Guidance, and OECD Safe Harbour guidance. As such, it is expected that, for example, the transitional CbyC Reporting Safe Harbour will be applicable for both IIR and DMTT purposes. The bill further clarifies that any amendments made to the Administrative Guidance by the OECD could be used for interpretation of the law for fiscal years beginning after the date the amendment is approved by the Inclusive Framework. However, the government may specify a different effective date or declare the amendment inapplicable.
- *Administration*: The GIR would need to be filed within 15 months following the end of the fiscal year (18 months for the transitional year). The bill provides for the possibility to appoint a domestic designated entity to do the filing and payment of any top-up tax on behalf of all domestic constituent entities and domestic joint ventures (although each local constituent entity is jointly liable to pay). Local constituent entities may be exempt from their GIR filing obligations if a GIR is filed in another jurisdiction that has a Qualifying Competent Authority Agreement with Gibraltar. In that case the local constituent entities would need to file a notification no later than three months prior to the filing due date of the GIR. Any top-up tax is to be paid on or before the due date for filing the GIR (if the top-up tax is calculated in a foreign currency, it must be converted into an equivalent sum in sterling using the average exchange rate for the financial year to which it relates).

For more information on local implementation of Pillar Two, please refer to the implementation tracker in KPMG's Digital Gateway.

Guernsey

Regulation to implemented Pillar Two rules enacted

On November 26, 2024, the Parliament in Guernsey passed regulations to implement Pillar Two rules into domestic law.

Key takeaways from include:

- *General*: the law provides for a Multinational Top-Up Tax (MTT) - equivalent to the IIR - and a Domestic Top Up Tax (DTT) applicable to financial years starting on or after January 1, 2025. The law confirms that a UTPR is not implemented in Guernsey at this stage.
- *DTT*: the DTT would generally follow the regular GloBE rules for calculating the ETR and Top-up Tax liability. However, the DTT would be imposed with respect to 100 percent of the Top-up Tax calculated for local constituent entities (i.e., it cannot be limited to the UPE's ownership percentage in the local constituent entities). Cross-border taxes, such as CFC taxes that would be allocated to domestic constituent entities under the regular GloBE rules, need to be excluded

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for DTT purposes. In addition, the law requires for the DTT to be determined based on information from financial statements prepared in accordance with the UPE's Financial Accounting Standard, except where it is not reasonably practicable to use such accounts. The DTT does not apply to securitization entities and flow-through entities that are treated as stateless entities.

- *Safe Harbour provisions:* It is expected that the transitional CbyC Reporting Safe Harbour, the permanent QDMTT Safe Harbour and the permanent Simplified Calculation Safe Harbor for non-material constituent entities will be applicable (due to the reference to the OECD Safe Harbours and OECD Administrative Guidance in the regulation).
- *Appointment of a Domestic Filing Entity*: Each MNE group with constituent entities, joint venture, or joint venture subsidiary in Guernsey must appoint one domestic filing entity that is responsible for the registration and filing requirements of the group.
- *Registration*: The law requires each in-scope group to register within twelve months from the start of the group's UPE first accounting period in scope of Guernsey's legislation or six months from the date that the entity becomes a member of the MNE Group (whichever of the periods is last to end). The registration must be done by the domestic filing entity.
- *Filing requirements*: Groups in scope would be subject to several filing requirements. This includes the filing of the GIR, a DTT return on the self-assessed amount of QDMTT due, and a MTT return on the self-assessed amount of IIR top-up tax due. All returns would need to be filed within 15 months after the end of the reporting fiscal year (with an exception for the first year where the deadline is 18 months after the end of the first reporting fiscal year.) As for the registration, the filings would be done by the domestic filing entity.

No further legislative steps are required for the rules to apply such that the rules are considered enacted.

For more information on local implementation of Pillar Two, please refer to the implementation tracker in KPMG's Digital Gateway.

Hungary

Legislative amendments and final registration form relating to Pillar Two law published

On November 28, 2024, the legislative amendments to the Hungarian Pillar Two law were published in the Official Gazette, along with a final registration form. The proposed amendments were updated during the legislative process to align with the draft registration form released on November 15, 2024.

Key takeaways include:

- *Registration:* For Pillar Two registration purposes, groups are required to provide information on constituent entities based in Hungary and on the UPE, rather than all members of the MNE group, as initially proposed (see E-News Issue 202). The registration deadline remains unchanged with submissions due 12 months from the beginning of the tax year concerned (i.e., December 31, 2024, in case of calendar year taxpayers).
- *Advance payments:* The legislative amendments also require domestic constituent entities or domestic designated constituent entities to declare and pay a DMTT tax advance liability by the 20th day of the 11th month following the last day of the tax year. The declaration must include the identification details of the domestic group member and the expected DMTT tax liability.

For more information, please refer to a November 22 report and November 27 report prepared by KPMG in Hungary.

Ireland

Finance Act 2024 enacted

On November 12, 2024, the Irish President signed into law the Finance Act 2024. Key measures included in Finance Act 2024 include:

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- Introduction of a participation exemption regime for certain distributions.
- Technical amendments to the Irish DAC7 law.
- Technical amendments to the interest limitation rules.
- Introduction of Pillar One Amount B.
- Amendments to the Pillar Two legislation.

For more information on these different measures, please refer to E-News Issue 201.

Isle of Man

Pillar Two law enacted

On November 21, 2024, the Parliament in the Isle of Man passed the Global Minimum Tax (Pillar Two) Order 2024. As a result, the legislation is considered enacted and will introduce a DMTT and IIR as from January 1, 2025.

For more information, please refer to E-News Issue 202.

Italy

Guidance on permanent establishment investment management exemption published

On November 19, 2024, the Italian tax authorities published a Circular Letter providing further guidelines on the Italian permanent establishment exemption for investment management, as introduced in the 2023 Budget Law.

The regime was enacted effective January 1, 2023, and provides that foreign investment vehicles and their direct or indirect subsidiaries should not be deemed to have an Italian permanent establishment provided certain conditions are met in connection with the activities of an investment manager. Among others, the letter provides for guidance on the independence requirement for non-resident investment vehicles and for the asset/investment manager. It specifies conditions under which the independence of the investment vehicle from its investors is maintained. The independence requirement, while safeguarding a clear separation between the investment risk (which is borne by the investors), and the business risk (which is borne by the management company), ensures that the investments made through the non-resident investment entity are not attributable to the management company. If this requirement is met, no permanent establishment is deemed to exist in Italy, provided the remaining conditions are also met. The guidance is aimed at reducing the risk of a permanent establishment arising in Italy, which could deter investment managers from locating in the jurisdiction.

The letter also includes guidelines on the application of the arm's length principle on asset management transactions and on the transfer pricing documentation required for the permanent establishment investment management exemption regime.

For previous coverage, please refer to E-News Issue 186.

Netherlands

New decree on OECD Amount B

On December 4, 2024, the Dutch Deputy Minister of Finance published a new decree on the position of the Netherlands with regard to Amount B of Pillar One.

Key takeaways include:

- Amount B rules will not apply to baseline marketing and distribution activities in the Netherlands. However, the Netherlands will honor their commitment towards the OECD and accept the outcome of other jurisdictions applying Amount B.

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- A corresponding adjustment to transfer prices as relief for double taxation will be provided if the covered jurisdiction has (1) implemented Amount B in local laws and regulations, (2) correctly applied Amount B, and (3) a bilateral tax treaty in force with the Netherlands.
- The Amount B decree will apply to affiliated entities (legal entities), but also to the profit allocation to permanent establishments (PE), even though the OECD Amount B guidance has not clarified the applicability to PEs.

The decree will take effect on January 1, 2025.

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

Norway

Consultation launched on draft legislation to introduce reporting obligations for crypto-asset service providers

On November 15, 2024, Norway's Ministry of Finance released for public consultation a draft bill proposing the introduction of due diligence procedures and reporting requirements for crypto-asset service providers by implementing the OECD's Crypto-Asset Reporting Framework (CARF).

In-scope crypto-asset service providers would be required to collect and verify information from users, in line with specific due diligence procedures. Subsequently, certain information relevant for both income and wealth tax purposes would need to be reported to the Norwegian authorities.

According to the Ministry's press release, the proposal contains an extended scope compared to CARF by requiring qualifying service providers to provide information about all users (i.e., foreign and Norwegian users). The release further notes that information on the users' deposited assets will also be required and that the disclosure obligation will also include pure custody services.

Feedback to the public consultation can be provided until February 15, 2025. It is proposed that the new rules will enter into force from 2026, with the first reporting starting in early 2027.

Poland

Minimum taxation rules (under Pillar Two) enacted

On November 19, 2024, legislation implementing the EU Minimum Tax Directive was published in the Polish Journal of Laws.

The legislation largely aligns with the provisions of the Directive, with an exception concerning the date of entry into force, i.e., the IIR and DMTT will become applicable for financial years starting on or after December 31, 2024. This represents a one-year deferral compared to the implementation timeline required by the EU Minimum Tax Directive. However, taxpayers have the option to make an irrevocable election to apply the rules earlier, starting from January 1, 2024. Where such an election is made, the UTPR will become applicable one year, i.e., for financial years starting on or after January 1, 2025.

Compared to a previous version of the legislative proposal (see E-News Issue 195), the enacted law requires the DMTT to be determined based on information from financial statements prepared under the Polish Accounting Act, i.e., the Polish GAAP, subject to certain conditions. In addition, the previously proposed election to use the financial accounting standard of the UPE for a period of up to five years has been removed.

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

Note that Poland is one of the countries that has failed to transpose the EU Minimum Tax Directive into domestic legislation by December 31, 2023. Therefore, Poland, together with Cyprus, Portugal and Spain, were referred by the European Commission to the CJEU on October 3, 2024. For previous coverage, please refer to E-News Issue 201.

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General ruling on the requirement of effective taxation of dividends for WHT purposes

On November 20, 2024, the Polish Minister of Finance published in the Polish Official Gazette a general ruling on conditions to benefit from the dividend withholding tax (WHT) exemption.

More specifically, the general ruling dismisses previous practice by Polish tax authorities and the administrative court, which required an effective taxation of outbound dividends in the hands of foreign recipients and denied WHT relief where such dividends are exempt from taxation at the level of the shareholder.

Key takeaways from the ruling include:

- The general ruling confirms that the WHT exemption requires the recipient of dividends to be subject to worldwide income taxation in Poland or in another Member State of the European Union (EU) or the European Economic Area (EEA) (i.e., to be considered a tax resident of an EU or EEA jurisdiction).
- This condition can be met where the dividend is exempt in the hands of a tax resident of the EU or EEA based on local relief provisions implementing the EU Parent-Subsidiary Directive (PSD).
- The ruling provides further examples where the WHT relief conditions may be considered to be met (e.g., absence of taxation due to tax loss utilization), subject to the anti-avoidance clause in the Polish implementation of the PSD - art. 22c of the Polish Corporate Tax Act.

Although the general ruling is not considered a source of law, taxpayers and tax remitters may nevertheless benefit from its provisions, similar to the level of certainty granted by an individual tax ruling.

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

General ruling on the requirement of effective taxation of interest and royalties for withholding tax purposes

On November 27, 2024, the Polish Ministry of Finance published in the Polish Official Gazette a general ruling on conditions to benefit from the interest and royalty WHT exemption. The ruling at hand follows the lines of the general ruling on the taxation of dividends described above.

Key takeaways from the ruling include:

- The condition provided by the Polish law that the exemption applies only if the recipient is "not benefiting from income tax exemption on its total income, irrespective of its source" has to be interpreted as meaning that the recipient:
  - does not benefit from an income tax exemption on its total income, or any part thereof, nor does it benefit from an income tax exemption on any specified income category, and/or
  - does not benefit from any preferential tax rules applicable to interest / royalties. The fulfilment of this condition should be assessed through the lens of the tax laws in force in the country of tax residence of the recipient of interest and royalties, being their beneficial owner, or through the lens of specific tax incentives granted by the tax administration of that country to such an entity (e.g., by way of an administrative decision).
- the fact that, due to individual circumstances, the taxpayer does not pay income tax in its country of residence on the income earned in a given period (e.g., due to the utilization of tax losses) should not, per se, indicate that the analyzed condition is not satisfied.

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

Draft regulation to update national list of tax haven jurisdictions

On November 18, 2024, the Polish Ministry of Finance published a draft regulation to update the list of tax haven jurisdictions, last revised on March 29, 2019.

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The draft regulation proposes the removal of Andorra from the Polish list of tax havens. As a result, the list would include the following 25 jurisdictions with effect from January 1, 2025: Anguilla, Antigua and Barbuda, Bahrain, the British Virgin Islands, the Cook Islands, Curaçao, Dominica, Grenada, Hong Kong (SAR, China), Liberia, Macau, the Maldives, the Marshall Islands, Mauritius, Monaco, Nauru, Niue, Panama, Saint Lucia, Samoa, Sark, Seychelles, Sint Maarten, Tonga, the US Virgin Islands and Vanuatu.

A public consultation on the draft regulation was open until November 27, 2024.

Note that the Polish list of tax haven jurisdictions is supplemented by a separate list of non-cooperative jurisdictions, which includes those jurisdictions considered non-cooperative by the EU list and that are not included on the Polish list of tax havens, namely: Fiji, Guam, Palau, Trinidad and Tobago, the Russian Federation and American Samoa. For more information on the Polish list of non-cooperative jurisdiction, please refer to E-News Issue 193.

Please also note that different national tax defensive measures are applied depending on whether a jurisdiction is included on the Polish list of tax havens or on the list of non-cooperative jurisdictions that mirrors the EU assessment. Defensive measures may include CFC taxation, 19 percent tax on shifted profits, limitation of participation exemption, broader scope of withholding taxation, DAC6/MDR reporting and increased Transfer Pricing documentation.

For more details on the EU listing exercise, please refer to KPMG's summary of defensive measures applied by EU Member States against non-cooperative jurisdictions.

Slovakia

Amendments to minimum taxation rules (under Pillar Two) adopted by Parliament

On November 28, 2024, the legislative amendments to the Slovakian Pillar Two law were approved by the Parliament.

As provided in the bill that was submitted to the Parliament in September, the amendments provide for changes to the applicable accounting standard for DMTT computation, the introduction of the permanent Safe Harbour for non-material constituent entities, changes to the transitional CbyC Reporting Safe Harbour and incorporation of several elements of the OECD Administrative Guidance into the law.

For previous coverage, please refer to E-News Issue 201.

Consultation on draft bill to implement DAC8

On November 25, 2024, the Ministry of Finance in Slovakia published for consultation a draft bill to transpose Council Directive (EU) 2023/2226 (DAC8) into domestic law. Key takeaways include:

- In accordance with DAC8, the bill would introduce rules on due diligence procedures and reporting requirements for crypto-asset service providers. In-scope crypto-asset service providers would be required to collect and verify information from EU clients, in line with specific due diligence procedures. Subsequently, certain information would be reported to the relevant competent authorities in Slovakia. This information would then be exchanged by the tax authorities of Slovakia with the tax authorities of the Member State where the reportable user is tax resident.
- As required under DAC8, the bill would expand the scope of the automatic exchange of advanced cross-border rulings to also include rulings issued to individuals (DAC3).
- The bill also provides for amendments to the reporting obligations in respect of cross-border arrangements (DAC6). This includes changes to the notification requirements for intermediaries bound by legal professional privilege and amendments to the information reportable under DAC6.

The deadline for submitting feedback to the public consultation is December 13, 2024. This follows an earlier consultation on the DAC8 implementation held in spring 2024 – see E-News Issue 194.

The rules should be applied for reporting periods starting from January 1, 2026.

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Slovenia

Act on amendments to the income tax act published

On November 26, 2024, legislation to amend the Corporate Income Tax Act was published in the Official Gazette of Slovenia.

In line with the previous draft, the bill provides for time limitations regarding the carry forward of tax losses, the possibility to carry-forward unused portions of the digital and green transition allowance and changes to the local interest deduction limitation rules to align with the Anti-Tax Avoidance Directive (ATAD).

The bill entered into force on November 27, 2024, and applies to tax periods beginning on or after January 1, 2025.

For previous coverage, please refer to E-News Issue 203.

Spain

Minimum taxation rules (under Pillar Two) submitted to Senate

On November 25, 2024, legislation to transpose the EU Minimum Tax Directive was approved by the Spanish Congress and was subsequently submitted to the Senate.

Key takeaways include:

- *General:* The bill is generally aligned with the EU Minimum Tax Directive and would introduce a DMTT and the IIR for fiscal years beginning on or after January 1, 2024, as well as the UTPR, applicable for fiscal years beginning on or after January 1, 2025.
- *DMTT:* the DMTT would generally follow the regular GloBE rules for calculating the ETR and Top-up Tax liability. However, the DMTT would be imposed with respect to 100 percent of the Top-up Tax calculated for local constituent entities (i.e., it cannot be limited to the UPE's ownership percentage in the local constituent entities). Cross-border taxes, such as CFC taxes that would be allocated to domestic constituent entities under the regular GloBE rules, need to be excluded for DMTT purposes. In addition, the law requires for the DMTT to be determined based on information from financial statements prepared in accordance with the UPE's Financial Accounting Standard, except where it is not reasonably practicable to use such accounts.
- *Safe Harbours:* the law would incorporate the transitional CbyC Reporting Safe Harbour and the transitional UTPR Safe Harbour. In addition, the law provides for a QDMTT Safe Harbor rule (i.e., IIR and UTPR Top-up Tax are deemed to be zero in Spain in relation to other jurisdictions that apply a QDMTT, subject to conditions).
- *Filing and payment:* the GIR must be filed within 15 months after the end of the fiscal year (18 months for the transitional year). An option is provided to transfer the obligation to file the GIR to another constituent entity (along with the requirement to notify the local tax authorities where the GIR has been filed by a foreign constituent entity). Any top-up tax would need to be declared and paid within the same deadline. In addition, local constituent entities would be required to submit a top-up tax return (self-assessment) and to pay top-up tax within 25 calendar days following the 15th month after the end of the tax period (18 months for the transitional year). The self-assessment filing and payment of tax liability would need to be carried out, where appropriate, by only one entity of the group that is designated by the legislator.
- *Penalties:* Penalties would vary depending on the offence and severity and may reach a fixed monetary fine of EUR 10,000 for each item or set of data that should be included in the return (capped at a maximum of 1 percent of the net turnover of all group members (including excluded entities) as recognized in the Consolidated Financial Statements prepared at UPE level.

It is expected that the Senate will vote on the law by December 18, 2024. Amendments may still occur as a result of the Senate discussions and would also require approval by the Congress.

On December 4, 2024, the Spanish General Directorate of Taxes opened a consultation on draft regulations (see draft regulatory decree and draft regulatory impact analysis) for the proposed Pillar Two bill. The draft regulations aim to clarify the

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interpretation of the rules by incorporating additional guidance from the OECD and the EU. Several topics are covered in the draft regulations, including mismatches in financial years, the treatment of tax credits, and adjustments relevant to insurance entities. The draft regulations also indicate that the GIR will be approved through a ministerial order. Comments are due by December 26, 2024.

Please also refer to a report prepared by KPMG in Spain as well as our previous coverage in E-News Issue 190.

United Kingdom

Guidance published on top-up tax payments and new online service for changing the filing entity

On November 20, 2024, HMRC provided practical information on the payment of top-up taxes under the DMTT and IIR. The guidance outlines the information companies need for their top-up tax payments, including available payment methods, and necessary account details. Under current legislation, top-up tax payments should be made within 15 months after the end of the reporting fiscal year (18 months for the transitional year). Finance Bill 2024-2025 clarified that the first payment may not be earlier than June 30, 2026 (for previous coverage, please refer to E-News Issue 203).

On the same day, HMRC also opened a new online service on its website for companies wishing to change their filing constituent entity. The communication also includes information required for this procedure and emphasizes to taxpayers that such a notification must be done within six months of the change.

New guidelines on patent box computations

On November 7, 2024, HMRC released information and guidance on UK's patent box computations.

By applying the patent box regime, companies can benefit from a reduced corporate tax rate of 10 percent for profits from patented inventions.

HMRC has published the new guidelines to address common errors in patent box computations, provide necessary information, and to highlight potential problem areas. The document makes it clear that the Guidelines “do not represent any change in the law or HMRC policy”.

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

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Local courts

Key Insights

- German CFC Rules – Functional Approach / Violation of the free movement of capital in third-country cases
- Italian Supreme Court ruled on beneficial ownership status for reduced withholding tax on royalties
- Federal Supreme Court decision on the beneficial ownership concept (Double Tax Treaty)

Germany

German Fiscal Court decision on CFC rules – Functional Approach / Violation of the free movement of capital in third-country cases

On August 2, 2024, the German Fiscal Court of Düsseldorf (case 1 K 2666/19 F) issued a decision on two issues related to the German Controlled Foreign Company (CFC) Rules[5]:

- the application of the so-called "functional approach"[6], and
- whether the rules infringe the EU free movement of capital with respect to third countries due to the absence of a motive test in third country cases[7].

In the case under dispute, the plaintiff (a German corporation) held a 100 percent interest in a stock corporation domiciled in Switzerland. The subsidiary was responsible for the central settlement and liability guarantee business (del credere) for the purchase of goods within the plaintiff's group of companies. The Swiss corporation also carried out payment settlement for intra-group and external business partners, bore the default risk in relation to external suppliers, and generated interest income from interest on arrears and short-term investments. The case centered around the question of whether the income of the Swiss subsidiary was subject to German CFC taxation in the hands of the German parent in the years 2009 to 2011.

The Fiscal Court of Düsseldorf (the Court) ruled that the German CFC Taxation rules do not apply in this case. To decide whether the low-taxed subsidiary has passive income, the Court took a two-step approach. In a first step, all activities of the subsidiary

[5] The German CFC rules (Sections 7 et seq. German Foreign Transactions Tax Act [FTTA]) apply in general if a low-taxed corporation domiciled abroad generates passive income and is controlled by a person with unlimited tax liability in Germany. The FTTA contains an exhaustive catalog of active income. All income that is not active in this sense is deemed to be passive income and therefore harmful for the purposes of German CFC rules (especially interest income, unless it is connected to active income according to the so-called functional approach). The low tax threshold was 25 percent, reduced to 15 percent from 2024. The legal consequence of the German CFC Rules is that the passive income of the foreign corporation is to be recognized as a taxable add-back amount for the resident in proportion to their share in the nominal capital of the foreign entity. The aim of the rules is to prevent the transfer of income to low-taxed foreign countries. As a result, passive income is taxed as if it had been generated directly in Germany (upward shift to the domestic tax level).

[6] The functional approach provides that even if individual activities within a business function qualify as passive, all activities are classified as active if the main economic activity of the function is deemed active.

[7] German CFC taxation can be mitigated in EU/EEA cases if proof is provided that the foreign corporation pursues a significant economic activity (so-called motive test). The motive test is intended to ensure that the German CFC Rules comply with European Union law.

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which are economically related must be "aggregated" in separate groups. Subsequently, in a second step, it has to be determined if the main activity/function of each group is deemed to be active income (so called "functional approach"). The court decided that payment settlement was the main activity of the foreign subsidiary. Furthermore, payment settlement was deemed to be active income even though it is not mentioned as active income in the exhaustive statutory catalog of active income in the German CFC rules. As a consequence, the Court concluded that overall the subsidiary generates active income from the operation of a credit institution and from services (both active income according to the exhaustive statutory catalog), as the activity of payment settlement can be categorized under those two activities.

The Court also held that, for 2011, the German CFC taxation regime leads to an unjustified violation of the free movement of capital[8]. For foreign companies domiciled in the EU, the law allows the German parent to prove that the foreign subsidiary pursues an economic activity abroad (motive test), so that passive income is not subject to German CFC taxation. However, the law does not provide for this possibility with respect to subsidiaries resident in third countries. The Court noted that, as of 2011, the amended information clause in the Double Tax Treaty between Germany and Switzerland provides the German tax authorities with an opportunity for review. Not providing for a rebuttal option with respect to Swiss entities for the purposes of German CFC rules is therefore no longer justified for reasons related to the prevention of tax avoidance. The Court also took the view that the subsidiary in the case in question was not a purely artificial arrangement but was actually located in Switzerland and carried out an economic activity there.

The German tax authorities did not appeal the decision in front of the tax supreme court.

Italy

Italian Supreme Court ruled on beneficial ownership status for reduced withholding tax on royalties

On October 14, 2024, the Italian Supreme Court issued decision no. 26640. The decision addressed the issue of proving the beneficial ownership status for the application of the reduced withholding tax on royalties paid under Article 12 of the Double Tax Treaty concluded between Italy and Luxembourg.

The issue at hand was whether the Italian plaintiff had provided sufficient proof to demonstrate that a company based in Luxembourg was the beneficial owner of royalties paid for trademarks, and consequently, whether the reduced withholding tax rate of 10 percent under Article 12 of the Italy-Luxembourg Double Tax Treaty could be applied. Specifically, the case dealt with the tax treatment of royalties paid by the Italian company to Luxembourg-based companies that owned and licensed the trademarks used for the operation of hotels in their respective facilities. The Italian Tax Authorities argued that the plaintiff did not correctly identify the beneficial owner of the royalties, by claiming that the Luxembourg company was merely an intermediary (i) with no exclusive control of the trademark, (ii) that did not suffer the risk of the trademark's decrease in value, (iii) that had a minimal structure and very few employees (iv) and that did not perform any operational, coordination and control functions, which instead were exclusively performed by the US parent company. According to the Italian Tax Authorities, the beneficial owner was the US company, which exercised direct control over the operations through a network of related companies and subsidiaries located in Luxembourg, leading to the non-recognition of the reduced withholding tax.

The Supreme Court referred to settled case-law, particularly in respect of the criterion for "beneficial ownership", according to which only the entity that has actual legal and economic control over the income can benefit from the advantages guaranteed by double tax treaties. Otherwise, in the Court's view, there would be an improper transfer of treaty benefits (Decision no. 32840/2018).

This concept has been further expanded by the Supreme Court (e.g., in Decision no. 6005/2023), although in reference to the exemption on intra-group interest under the Italian law implementing the EU Interest and Royalties Directive (Directive 2003/49/EC).

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[8] The free movement of capital also applies to third countries, i.e., Switzerland in the case of the judgement at hand. Please note: For years from 2022 onwards, the German CFC-rules also contain a motive test for third-country cases for a limited scope of application. However, this only applies to income of an investment nature (in particular interest income, unless it is active on the basis of the functional approach) and if the foreign company is not controlled. In the case of income of an investment nature, any amount of investment may be harmful in exceptional cases.

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According to existing case law, it is the taxpayer's responsibility to prove its status as the beneficial owner by demonstrating that it passes three independent and separate tests:

- The *substantive business activity test*, which aims to verify whether the receiving company carries out real economic activity.
- The *dominion test*, which checks whether the receiving company can freely dispose of the income or whether it is compelled to pass it on to a third party.
- The *business purpose test*, which assesses the reasons for the interposition of a company in the cross-border income flow, to determine whether the company is a mere conduit, primarily or exclusively set up for tax savings.

The same principle was confirmed by the recent Supreme Court Decision no. 23628/2024, which addressed the treatment of dividends under the EU Parent-Subsidiary Directive (Directive 2011/96/EU) and essentially extended the principles established for interest and royalties to dividends. For more information on this case, please refer to E-News Issue 203.

In light of these principles, the Supreme Court confirmed the correct application of the reduced treaty rate. Specifically, the Supreme Court took the view that the Luxembourg company was the actual beneficiary of the royalties, having properly demonstrated compliance with the tests, particularly (i) the performance of real economic activity (utilizing the trademarks and licensing them to third parties), (ii) the right to freely dispose of the royalties without the obligation to pass them on to third parties, and (iii) the performance of an economic function as the holder of the exploitation rights of the trademarks.

Switzerland

Federal Supreme Court decision on the beneficial ownership concept (Double Tax Treaty)

On October 3, 2024, the Swiss Federal Supreme Court (the Court) issued a decision addressing the beneficial ownership concept in the context of a foreign bond payment fully hedged with cross-currency rate swaps (ref. 9C_635/2023).

The plaintiff was a Danish credit institution which acquired Swiss federal bonds. In parallel, the credit institution entered into cross-currency interest rate swaps. The remaining term of the swaps exactly corresponded to the term of the Swiss federal bonds. Effectively, the transaction was structured in such a way that the plaintiff was fully hedged against currency fluctuations of the CHF against the USD, as well as against interest rate changes. However, the Danish credit institution still bore the (very low) default risk of the Swiss federal bonds.

The Swiss Federal Tax Administration (ESTV) refused to refund the withholding tax on the interest from the Swiss federal bonds, as it did not consider the plaintiff to be the beneficial owner of the interest. The ESTV argued that the plaintiff did not bear any significant bond-specific risks (because of Switzerland’s excellent credit rating) and that the income from the bonds had to be passed on due to the swaps. At first instance, the plaintiff filed a complaint against the decision of the ESTV, which was dismissed by the Federal Administrative Court.

In a first step, the Supreme Court examined the beneficial ownership claim in light of the double tax treaty between Switzerland and Denmark. The Court found the Danish credit institution to be the beneficial owner as it was under no contractual or legal obligation to pass on the interest payments to another party. The Court noted that the obligations deriving from the swap agreement had to be fulfilled even in the unlikely case that the Swiss Confederation defaulted on the interest payments. The Court further noted that if the recipient bears the default or credit risk, transferring other market risks does not harm the recipient’s status as beneficial owner.

In a second step the Court clarified that, despite the recipient being deemed to be the beneficial owner of the payment, the withholding tax refund would not be available in the case of tax evasion or treaty abuse. The Court did not have sufficient evidence to rule on the question of treaty abuse and therefore referred back to the lower court (Federal Administrative Court). However, the Court did clarify that tax avoidance only exists if (a) the chosen legal arrangement is unusual, inappropriate, or completely unreasonable given the economic circumstances (objective element), (b) it is assumed that the arrangement was chosen solely to save taxes (subjective element), and (c) the chosen approach would result in significant tax savings if accepted by the tax authority (effective element). The Court added that a financial expert might need to review the issues to help the lower court determine whether the arrangement was unusual and intended for tax avoidance or abuse.

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The state of tax transparency in Europe

On December 2, 2024, the European Business Tax Forum (EBTF) published a study on The state of tax transparency in Europe. The report was prepared by the KPMG member firms in Europe. The report features:

- *The results of a comprehensive benchmark analysis covering key European multinationals*: conclusions and trends on qualitative and quantitative disclosures made by 185 European groups. This analysis was conducted using a set methodology developed based on the requirements of the GRI-207: Tax standard and covers tax disclosures for both 2022 and 2023. Sector-specific insights are provided for the energy & natural resources, financial services, consumer goods & retail, and industrial manufacturing sectors.
- *Insights from the questionnaire*: insights from a survey completed by 75 multinational groups representing 40 percent of the European groups included in the scope of the project. These insights relate to a number of topics, including the rationale behind the decision to report/ not to report comprehensively on tax, stakeholder reactions, the approach to the EU public country-by-country reporting and the role of tax under the Corporate Sustainably Reporting Directive (CSRD).
- *Best practices*: a collection of best practices gathered through the one-on-one interviews conducted with a selection of questionnaire respondents. These best practices represent key themes that emerged in multiple interviews and cover a range of topics, from how to build a culture of responsible tax behavior within the organization to how to approach the tax transparency journey and make use of tax transparency reports.

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

EU Tax Perspectives webcast – December 10, 2024

On December 10, 2024, a panel of KPMG professionals took a deep dive into the state of play on EU direct tax initiatives, discussed what can be expected from the next Commission and explored future trends in global direct tax policy.

The session focused on:

- *BEPS 2.0 in the EU:* state of play on the implementation of the EU Minimum Tax Directive (Pillar Two, practical issues such as registration requirements, proposal for exchange of Pillar Two information between EU Member States (DAC9),
- *Incentives:* The impact of Pillar Two on incentives and recent country developments,
- *Tax transparency:* EU public country-by-country reporting forms, practical insights on upcoming publishing deadline for MNEs present in Romania, and trends and best practices in tax transparency,
- *State of play of key EU direct tax initiatives:* the Withholding Tax Relief Framework (FASTER), the Unshell Directive proposal, BEFIT, the Transfer Pricing Directive, review of the Directive for Administrative Cooperation.

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

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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.

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