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European Tax Brief

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Tax

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Editorial

Welcome to the latest issue of Moore Stephens *European Tax Brief*. This newsletter summarises important recent tax developments of international interest taking place in Europe and in other countries within the Moore Stephens European Region. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information only and should not be acted upon without first obtaining professional advice tailored to your particular needs. *European Tax Brief* is published by Moore Stephens Europe Ltd in Brussels. If you have any comments or suggestions concerning *European Tax Brief*, please contact the Editor, Zigurds Kronbergs, at the MSEL Office by e-mail at zigurds.kronbergs@moorestephens-europe.com or by telephone on +32 (0)2 627 1832.

Inside

Azerbaijan

New transfer-pricing and anti-avoidance rules

Substantial changes to Azerbaijan's Tax Code, introduced with effect from 1 January 2017, include new anti-avoidance measures and comprehensive transfer-pricing rules.

As regards anti-avoidance, the tax authorities may now, where they consider the taxpayer has made use of a tax-avoidance scheme, make adjustments to counteract the tax advantages otherwise obtainable under the scheme. A tax-avoidance scheme is defined as any arrangement or transaction made or carried out with the intention of obtaining a tax advantage.

Furthermore, payments made by an Azerbaijani-resident to persons located in a jurisdiction considered to have a preferential tax régime will have to be made under a 10% withholding tax, and transactions with such persons may be subject to anti-avoidance provisions. The list of jurisdictions concerned will be updated on an annual basis.

The new transfer-pricing rules will apply to 'controlled transactions', defined as transactions between:

- An Azerbaijan resident and a related non-resident
- A non-resident party's Azerbaijan permanent establishment and the non-resident party or its permanent establishment in another country
- An Azerbaijan resident or Azerbaijan permanent establishment and an entity registered in a preferential-régime jurisdiction

Persons are considered to be related where:
- One directly or indirectly holds at least 20% of the shares or voting power in the other
- Both are under the direct or indirect control of the same third person or have direct or indirect control of the same third person
- One reports to or is under the direct or indirect control of the other person
- Both are members of the same family

Under new documentation requirements, taxpayers must make an annual report of their controlled transactions if these exceed AZN 500 000 in total, by 31 March of the following year.

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European Union

Panama Papers schemes said to have cost countries up to EUR 237 000 million

A study commissioned by the European Parliament estimates that the 28 EU Member States may have lost between EUR 109 000 million and EUR 237 000 million in tax revenues from the tax-avoidance schemes disclosed in the Panama Papers.

The study arrived at this figure by calculating the losses to eight states: Cyprus, the Czech Republic, Denmark, France, Germany, Poland, Spain and the United Kingdom and then extrapolating for the EU as a whole.

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Europe fails to agree on VAT measures

At their recent meeting, European Union finance ministers failed to reach agreement on two VAT measures.

The first would have allowed Member States to charge a reduced rate of VAT on e-books. Supplies of e-books must currently be charged at the standard rate of VAT, whereas most Member States exercise the option to charge a reduced rate on printed books.

The second measure would have allowed Member States to introduce a temporary reverse charge, under certain circumstances, on all goods and services invoiced at more than EUR 10 000. Under the reverse charge, the liability for payment of VAT falls on the customer rather than the supplier.

It is understood that opposition from one or two Member States to one proposal led to objection by other states to the second proposal. Decisions require unanimity.

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VAT cultural services exemption may be selective

The Court of Justice of the European Union (CJEU) has held that the exemption for cultural services under what is now Article 132(1)(n) of the VAT Directive leaves it at the discretion of Member States precisely which of such services they may exempt.

In *Commissioners for Her Majesty's Revenue and Customs v British Film Institute* (Case C-592/15), the British Film Institute, a non-profit body for promoting cinema in the United Kingdom, had applied for repayment of output VAT it had charged on admission tickets in the period from 1990 to 1996, arguing that it provided cultural services as envisaged by the Directive, which should have direct effect because it had not been effectively transposed by the United Kingdom. UK law (Value Added Tax Act 1994, Schedule 9 Group 13) currently exempts only admissions by a public or non-profit body to theatrical, musical or choreographic performances of a cultural nature (as well as admissions by such a body to museums, galleries and art exhibitions of a cultural nature). Admissions to cinemas are not exempt.

The CJEU held that the VAT Directive referred to 'certain cultural services', thus leaving it to Member States to define which services of that nature should benefit from the exemption. It followed that it could not be relied on directly in the absence of transposition.

The UK Court of Appeal, which referred the questions to the CJEU, must now decide the case in the light of this judgment.

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A transfer of property to settle a tax debt is not a supply for VAT purposes

The CJEU has held that the transfer of ownership of immovable property by a taxable person to a governmental authority in settlement of a tax debt does not constitute a supply of goods for consideration subject to VAT.

In *Minister Finansów v Posnania Investment SA* (Case C-36/16), Posnania Investment was a Polish property-dealing company that transferred ownership of some undeveloped land to a Polish local authority in part-settlement of a tax debt. The Polish tax authorities had assessed Posnania to VAT on the transfer on the grounds that the transfer was a taxable supply.

The CJEU noted that a supply of goods 'for consideration' required there to be a legal relationship between the supplier and the purchaser entailing reciprocal performance where the price received by the supplier constituted the value actually given for the goods supplied. Here, however, where the consideration was discharge of a tax debt, there was a legal relationship between the parties but there was no reciprocal performance, as tax was a compulsory charge the payment of which did not result in any performance on the part of the public authority to which it was paid, or therefore on the part of the taxable person.

It followed that a transaction of this nature was not subject to VAT.

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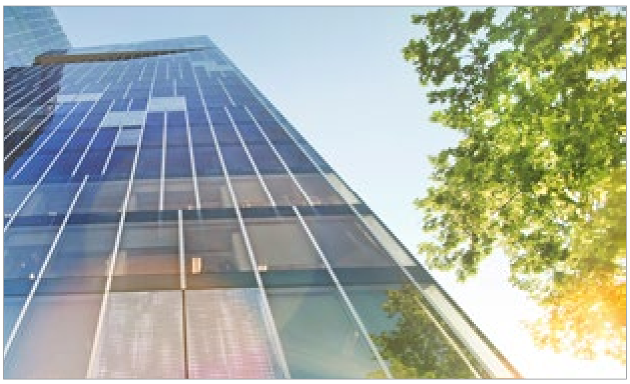

Agreement on double taxation dispute resolution

European finance ministers, meeting as ECOFIN (see also 'Europe fails to agree on VAT measures', above), have agreed on a binding mechanism for resolving disputes over double taxation, in the form of a draft Directive. The Directive must now be submitted to the European Parliament for its opinion and then placed before ECOFIN again for a final vote. If the procedure is successful, the Directive will apply to complaints submitted by taxpayers after 30 June 2019 in relation to tax years starting after 31 December 2017.

Currently, disputes over the right to tax are usually resolved via the 'competent authority procedure' under bilateral tax treaties, whereas transfer-pricing disputes may be resolved under the EU Union Arbitration Convention (90/436/EEC).

Under the new Directive, the resolution procedure would be binding and mandatory and it introduces time limits. As a first step, taxpayers would have to apply to the competent authorities of the Member States concerned. If those authorities failed to reach agreement within two years, the dispute would go to arbitration by an advisory panel of three to five independent persons together with no more than two representatives from both Member States. The panel would have six months in which to issue an opinion, which would be binding on both Member States, unless they agreed on an alternative solution.

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VAT agreement reached with Norway

See under Norway.

France

Restrictions on Mergers Directive unlawful

The CJEU has held that France's requirement that companies engaged in cross-border mergers must obtain prior approval from the French tax authorities in order to benefit from the EU Mergers Directive are in breach of EU law.

The Mergers Directive as applicable at the time of the transactions (90/434/EEC, now repealed and replaced by 2009/133/EC) allowed companies undergoing a cross-border merger within the European Union to defer tax on capital gains arising on the disposal of their assets to the acquiring company. In transposing the Directive into its own law (Articles 210C and 210B 3° *Code Général des Impôts*), France introduced a requirement for prior approval. Before claiming the benefits of the Directive, the companies concerned must provide evidence that the merger:

- is being carried out for bona fide commercial reasons
- does not have tax avoidance or tax evasion as its principal objective or as one of its principal objectives and
- is being carried out in such a way as will not preclude a tax charge on the deferred gains in future, where applicable

In *Euro Park Service v Ministre des Finances et des Comptes publics* (Case C-14/16), Euro Park Service was a Luxembourg company that absorbed its wholly owned French subsidiary, SCI Cairnbulg Nanteuil. Claiming the benefits of Article 210A, the subsidiary did not return any capital gains in its final tax return. The tax authorities raised an assessment for tax on the gains because the companies had not sought prior approval. When the case came before the Conseil d'Etat (the supreme administrative court), Europark argued that the requirement for prior approval was in breach of Article 49 TFEU (Treaty on the Functioning of the European Union), which guarantees the freedom of establishment), as there was no such requirement if the acquiring company was resident in France. The Conseil d'Etat referred this question to the CJEU.

The CJEU held that the French preconditions were indeed in breach of not only Article 49 but also of the Mergers Directive itself, for a number of reasons:

- Although Article 11(1)(a) (now Article 15(1)(a) of the 2011 Directive) permitted Member States to deny Directive benefits

where the transaction had tax evasion or tax avoidance as its principal objective or as one of its principal objectives, the corresponding French provision lacked certainty, because it gave leeway for discretion to the tax authorities in its application and required the lack of a response from the authorities for over four months to be read as a rejection
- The denial of benefits should be operated by way of exception, whereas the French legislation was based on a general presumption that the benefits would not apply unless the conditions were met
- The third condition was otiose and the three conditions as a whole went beyond the measure of competence allowed Member States by Article 11(1)(a)
- Case law had established that a presumption of tax evasion or tax avoidance could only be made where a transaction had obtaining a tax advantage as its sole objective
- As for Article 49 TFEU, the discrimination against cross-border mergers could not be justified as the French legislation went beyond what was proportionate.

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Germany

Pre-2016 loss set-off rules on change of company ownership held to be unconstitutional

The restrictions on the continuing use by a company of brought-forward tax losses where it undergoes a change of ownership of more than 25% but no more than 50% (by the direct or indirect transfer of shares or voting rights) within a five-year period have been held to be unconstitutional in the form in which they applied before 1 January 2016.

According to Germany's Federal Constitutional Court (*Bundesverfassungsgericht*) in a judgment released on 12 May 2017, the restrictions (which are contained in section 8c of the German Corporation Tax Act (*Körperschaftsteuergesetz* – KStG) as applicable until 31/12/2015 violated the principle of non-discrimination enshrined in the German Constitution. According to the Court, section 8c must now be amended no later than 31 December 2018, with retroactive effect for the period from 1 January 2008 to 31 December 2015. Failure to do so within the specified time limit will cause the present provisions to be deemed null and void on 1 January 2019, with retroactive effect from 1 January 2008.

The Court held that the objective of the law – to avoid abuse, e.g. by trading in inactive shelf companies with brought-forward tax losses – was legitimate and would generally justify special treatment. However, the legislation had exceeded the existing constitutional limits because the trigger for the anti-abuse measures was a transfer of ownership of more than 25%, which was insufficient in itself to indicate the existence of an abusive arrangement. Furthermore, the limitation envisaged by the law on the use of brought-forward losses where the company underwent a change of its economic identity, as well as a change of ownership, as a precondition for forfeiture or limitation of the loss set-off did not justify this treatment. In the reasoning of the Court, only a majority share but not a blocking minority of more than 25% would enable the purchaser of a shareholding to exercise significant control over the company so as to use available losses for his own purposes.

Whether the introduction of section 8d KStG, effective from 1 January 2016, which provides for an exception to the application of section 8c KStG (see *European Tax Brief* Volume 7, Issue 1 – April 2017, page 6) has had an impact on the constitutionality of section 8c KStG from 1 January 2016 onwards is a separate question. From that date, however, the loss restrictions, where based solely on the same grounds as mentioned above, may no longer be unconstitutional.

Affected companies should make sure to keep relevant tax assessments open and to appeal against assessments that are not yet final and binding. This recommendation also includes cases in which more than 50% of the participation of a company has been transferred, although the Constitutional Court has not expressly ruled on such cases. However, the German Federal Supreme Tax Court (*Bundesfinanzhof* – BFH) will shortly have to decide on such a case.

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Gibraltar

Gibraltar loses UK gambling duty appeal

The Court of Justice of the European Union has held that Gibraltar cannot be exempt from the United Kingdom's remote gambling duty (RGD), because for this purpose it is an integral part of the United Kingdom.

For an earlier report on this issue, see *European Tax Brief*, Vol 6 Issue 3, December 2016.

RGD, imposed in 2014, is a 15% 'point of consumption' tax on the use of online gambling services by UK residents. The tax has to be collected by operators, wherever they are based, and remitted to the UK Exchequer.

Gibraltar hosts several important online-gambling operators. Their trade body, the Gibraltar Betting and Gaming Association, challenged the application of RGD to Gibraltar, on the grounds that the tax was an unlawful constraint on the freedom to provide services guaranteed under article 56 TFEU.

The European Court, however, has ruled (in Case C-591/15) that, although Gibraltar does not form part of the United Kingdom, the provision of services by operators established in Gibraltar to persons established in the United Kingdom constitutes a situation confined in all respects within a single Member State.

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Norway

EU and Norway reach VAT cooperation agreement

The European Union and Norway (which is a member of the European Economic Area but not of the EU or of the European Customs Union) have initialled an agreement on administrative cooperation, recovery assistance and anti-fraud measures.

It has taken two years for the agreement to reach this stage; it must still be signed and then ratified by both parties.

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Organisation for Economic Cooperation and Development

OECD launches CRS disclosure facility

The OECD has launched a disclosure facility on its Automatic Exchange Portal, allowing interested parties to report potential schemes to circumvent reporting under the Common Reporting Standard (CRS), as part of its ongoing efforts to maintain the integrity of the CRS.

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Russia

New rules for claiming treaty relief

New requirements for documentary evidence that companies receiving passive income from Russia need to present to the Russian tax authorities in order to benefit from reduced rates of withholding tax granted in the relevant tax treaty have been introduced with effect from 1 January 2017.

Previously, it was sufficient for the foreign company receiving dividends, interest or royalties from a Russian company to present a tax residence certificate from its home country to the paying agent (usually the Russian company itself) responsible for deducting the withholding tax. Paying agents were entitled, but not obliged, to ask the foreign company for documentary evidence that it was the beneficial owner of the income.

Now, the foreign company will be obliged to provide evidence that it is the beneficial owner of the income. The Russian Ministry of Finance has issued guidance on the types of evidence required. The documents should demonstrate, among other things, that:

- The recipient is carrying on a genuine business in the treaty-partner country
- It does not transfer the income wholly or partly to a third person not entitled to the benefits of the particular treaty
- The recipient has the right and authority to dispose freely of the income received and is under no obligation to pass the income on to a third person
- The recipient is subject to tax in its residence state on the income received and confirms the absence of any withholding tax savings arising from the subsequent transfer of the income to third parties
- The functions that the recipient performs and the risks that it assumes are commensurate with the income received

Where the direct recipient does not meet these requirements, it must write to the Russian paying agent relinquishing its rights under the treaty and indicating that it is acting on behalf of a third party. If that third party is entitled to the benefits of the treaty, it must in turn provide the necessary documentation in order to enjoy the treaty benefits.

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Spain

Parent-Subsidiary exemption not due for lack of substance

A senior Spanish court has upheld the tax authorities' refusal to allow exemption from Spanish withholding tax on dividends paid by a Spanish company to an intermediate Danish holding company, on the grounds that the Danish company lacked substance.

In the case concerned (Case 264/2012), a Spanish company ('CLH') paid dividends from 2003 to 2005 to a Danish company owning 25% of the Spanish company's share capital. The Danish company, Enbridge Capital APS, was ultimately owned by a Canadian company, Enbridge Inc.

The dividends were paid under deduction of a 15% withholding tax (which is both the rate provided by Spanish domestic law and the rate applicable under the tax treaty between Spain and Denmark). Enbridge Capital applied to the Spanish tax authorities for a refund of the withholding tax, on the grounds that the dividends qualified for exemption under the EU Parent-Subsidiary Directive (90/435/EEC, now repealed and replaced by Directive 2011/96/EU). The Spanish authorities refused the application, invoking the Directive's anti-avoidance provision.

The court (the National Appellate Court – *Audiencia Nacional)* upheld the decision of the tax authorities, as it found that the Danish holding company lacked business substance and was in effect merely a conduit. In particular:

- It had no tangible assets such as equipment, fixtures and fittings and its office was rented out to a third party
- It had only one employee, who was seconded to Spain, and whose salary was borne by the ultimate Canadian parent company
- It carried out no business in Denmark. Although it contended that, besides managing the Spanish company, it was also seeking out and identifying potential investments in Europe, there was insufficient documentary evidence to support this contention

The decision of the Appellate Court, which may still be appealed to the Supreme Court, is entirely consistent with both the recent policy of the tax authorities to apply a rigorous standard of proof for foreign holding companies to have a business purpose other than to benefit from the tax advantage and to have sufficient human and technical resources to substantiate that purpose, and with jurisprudence, which has tended to uphold the authorities' position.

The case has importance beyond Spain, as illustrative of the trend towards increasing scrutiny by all Member States of holding-company structures benefiting from the Parent-Subsidiary exemption, and entirely at one with the BEPS framework.

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United Kingdom

Reintroduction of postponed tax measures confirmed

In order to clear the Parliamentary timetable for the general election held on 8 June, many tax measures had to be dropped, in the so-called wash-up procedure, so that a truncated Finance Bill could be enacted on 27 April. The omitted measures included some discussed in previous editions of this newsletter (e.g. "UK to proceed with end of permanent non-dom status" and "UK confirms plan to impose restrictions on interest relief" – for which see Vol 6 Issue 3, December 2016 and "Enabler penalty confirmed", Volume 7 Issue 1, April 2017).

The UK government has now announced that these measures will all be reintroduced, with minor modifications in certain cases, in a Finance Bill to be published in the autumn. Furthermore, they are mostly to apply from the date originally intended (1 or 6 April 2017, for example). What is uncertain, however, is the extent to which the measures may be amended in their passage through Parliament, given that the government depends on support from a minor party for its majority in the House of Commons.

There will also be a National Insurance Bill, to make previously announced amendments to the system of national insurance (social security) contributions, and a Customs Bill, to introduce a separate customs régime for the United Kingdom when it leaves the European Union in April 2019 – currently, the Government intends to leave the customs union as well as the single market.

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Tax treaty passport scheme extended

The double-taxation treaty passport scheme (DTTP), which facilitates withholding tax clearance for foreign lenders to receive interest free of UK withholding tax from UK borrowers, has been extended to a wider range of lenders and borrowers for loans taken out after 5 April 2017.

UK domestic law requires a withholding tax of 20% to be deducted from interest paid to non-resident lenders. Most of the United Kingdom's tax treaties provide for a reduced or zero rate of withholding tax, but lenders need to obtain clearance in advance before the reduced rate may be applied, on a loan-by-loan basis if they have made more than one loan to a UK borrower.

Under the DTTP, foreign lenders may obtain single clearance (the 'passport') from the UK tax authorities in respect of all loans to UK borrowers, and benefit from the reduced rate by simply producing the passport to the UK borrower. The passports are valid for a five-year period and are renewable.

Hitherto, the DTTP has applied solely to lending between companies. Under the extended scheme, however, non-corporate borrowers, such as partnerships, charities and individuals may also avail themselves of the DTTP. Foreign partnerships will be eligible as lenders if all partners or other beneficial owners of the income are resident in the same treaty-partner country and are individually entitled to the benefit of the treaty. The scheme will also be open to sovereign wealth funds and pension funds acting as lenders.

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Cultural services exemption passes muster

See under European Union.

Gibraltar operators not exempt from remote gambling duty

See under Gibraltar.

Currency table

For ease of comparison, we reproduce below exchange rates against the euro and the US dollar of the various currencies mentioned in this newsletter. The rates are quoted as at 6 July 2017, and are for illustrative purposes only.

Currency	Equivalent in euros (EUR)	Equivalent in US dollars (USD)
Euro (EUR)	1.0000	1.1196
Azerbaijan manat (AZN)	0.5194	0.5922

Up-to-the-minute exchange rates can be obtained from a variety of free internet sources (e.g. http://www.oanda.com/currency/converter).

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