OUTBOUND ACQUISITIONS: TAX PLANNING FOR EUROPEAN EXPANSION IN A CHANGING LANDSCAPE (2025)

João Luís Araújo
TELLES
Porto

Guillermo Canalejo Lasarte
Uría Menéndez
Madrid

Dr. Stefan P. Gauci
Attorney-at-Law
Malta

Andrea Højgaard Jørgensen
CORIT Advisory
Copenhagen

Fabienne Limacher
Walder Wyss AG
Zürich

Jenni Parviainen
Hannes Snellman
Helsinki

Stanley C. Ruchelman
Ruchelman P.L.L.C.
New York

James Somerville
A&L Goodbody
Dublin

Sjoerd Stokmans
Van Doorne N.V.
Amsterdam

Eloise Walker
Pinsent Masons LLP
London

Nairy Der Arakelian-Merheje
Der Arakelian-Merheje LLC
Nicosia

Michel Collet
CMS-Francis Lefebvre Avocats
Paris

Werner Heyvaert
AKD Benelux Law Firm
Brussels

Paul Kraan
Van Campen Liem
Amsterdam

Erik Nilsson
Svalner Skatt&Transaktion
Stockholm

Luca Rossi
Facchini Rossi Michelutti
Milan

Matthias Scheifele
Hengeler Mueller
Munich

Dr. Karin Spindler-Simader
Wolf Theiss
Austria

Dr. Wolf-Georg von Rechenberg
WVRLAW
Berlin

Rutger Zaal
AKD
Luxembourg

TABLE OF CONTENTS

1. Chart **1**

A. Notes 10

2. Introduction **23**

A. Global Tax Planning in a Pre-2018 World 23

i. Reduction of Taxes in Europe 23

ii. Foreign Tax Credit Planning in the U.S. 25

iii. Allocation and Apportionment Rules for Expenses 27

iv. Self-Help Through Inversion Transactions 28

B. Global Tax Planning in a Post-2017 World 31

i. European Attacks on Cross-Border Holding Companies and Tax Planning 32

ii. Revisions to U.S. Tax Rules Affecting Global Business 38

3. B.E.P.S. and Holding Companies **67**

A. Background 67

B. B.E.P.S. Action Plan 68

C. Reflecting a Sea Change in Acceptable Tax Planning 71

D. Effects on Holding Company Structures 72

E. B.E.P.S. Action 1: Addressing the Tax Challenges of the Digital Economy 72

i. Pillar One 75

ii. Pillar Two 85

F. B.E.P.S Action 2: Hybrid Mismatch 94

i. Focus 94

ii. Illustrative Fact Patterns 95

iii. Recommended Action 97

G. B.E.P.S. Action 3: Drafting Effective Controlled Foreign Company Rules 98

i. Focus 98

#40761577v1

ii. Recommended Actions 99
H. B.E.P.S. Action 4: Interest Deductions and Other Financial Payments 101
i. Focus 101
ii. Recommended Action 101
I. B.E.P.S. Action 5: Harmful Tax Practice 103
i. Focus 103
ii. Illustrative Fact Patterns 103
iii. Recommended Action 104
J. B.E.P.S. Action 6: Prevent Treaty Abuse 108
i. Focus 108
ii. Recommended Action 109
K. B.E.P.S. Action 15: Multilateral Instrument 113
i. Scope of the M.L.I. 113
ii. Main Provisions of the M.L.I. 114
iii. Conclusion 122
L. Concluding Remarks on the E.U.'s Action 123
4. European Tax Law 126
A. State Aid 126
i. Legal Framework and Definition of "State Aid" 126
ii. Application of State Aid Rules to Direct Business Taxation 129
iii. Recovery of Unlawful State Aid 133
iv. Illustrative Examples 134
B. Transparency Measures 147
i. Current Measures 147
ii. Framework for Business Taxation ("B.E.F.I.T.") 157
iii. Public Tax Transparency Rules for Multinationals 158
iv. Mandatory use of International Accounting Standards 159

#40761577v1

C. Anti-Abuse and Tax Avoidance Measures 162
i. General Anti-Abuse Doctrine Under E.U. Law......... 162
ii. Legislative Measures 165
D. Simplification of European Tax Law 176
E. Conclusion 177
5. Luxembourg 178
A. General... 179
i. Income Tax 179
ii. Capital Duty.. 180
iii. Annual Net Worth Tax 180
iv. C.F.C... 181
v. Hybrid Mismatch Rules and Reverse Hybrid Mismatch Rules 182
B. Participation Exemption 183
i. Dividends.. 183
ii. Capital Gains 185
C. Subject to Tax 185
D. Tax-Free Reorganizations 186
E. Exit Taxation 187
F. Luxembourg Permanent Establishment 188
G. Partial Participation Exemption 188
H. Withholding Tax in a Foreign Subsidiary's Country...... 188
I. Deduction of Costs... 190
i. Value Adjustments 190
ii. Financial Costs 191
iii. Liquidation Losses.. 194
J. Withholding Tax on Outbound Dividends and Capital Gains 194
i. Distributions on Shares... 194
ii. Interest Payment on Straight and Hybrid Debt.......... 195

iii. Capital Gains in Hands of Shareholders 196
K. Repurchase of Shares in a S.O.P.A.R.F.I. 196
L. Other Tax Issues 197
i. Debt-to-Equity Ratio 197
ii. Transfer Pricing Regulations 198
iii. General Anti-Abuse Rule ("G.A.A.R.") 200
iv. I.P. Regime 200
v. Real Estate Tax for Investment Vehicles 201
vi. Advance Tax Agreements and Advance Pricing Agreements 202
vii. State Aid Investigations by the European Commission 203
viii. Claim and Tax Objections 206
ix. Exchange of Information 206
x. Country-by-Country Reporting 208
M. S.I.C.A.R. 209
N. S.I.F. 210
O. R.A.I.F. 210
P. Securitization Vehicles 210
Q. Recent and Current Developments 213
i. Codification of the Practice of Redemption of Classes of Shares 213
ii. Amendments to the Minimum Net Worth Tax Rules 214
iii. Possibility to Opt Out of the Participation Exemption 214
iv. Pillar Two – Implementation in Luxembourg 215
v. Amendments to the Interest Deduction Limitation Rule 215
6. Switzerland .... Error! Bookmark not defined.
A. General: Overview of the Swiss Tax System .... **Error! Bookmark not defined.**

#40761577v1

B. Taxation of Companies in Switzerland**Error! Bookmark not defined.**

i. Corporate Income Tax . **Error! Bookmark not defined.**

ii. Capital Tax.................. **Error! Bookmark not defined.**

iii. Stamp Duty................. **Error! Bookmark not defined.**

iv. Securities Transfer Tax **Error! Bookmark not defined.**

v. Value Added Tax.......... **Error! Bookmark not defined.**

vi. Swiss Withholding Tax **Error! Bookmark not defined.**

vii. Tax Credit for Foreign Withholding Taxes.......**Error! Bookmark not defined.**

viii. Real Estate Capital Gains and Transfer Tax.....**Error! Bookmark not defined.**

C. Aspects of Swiss International Tax Law**Error! Bookmark not defined.**

i. Swiss Tax Treaty Network**Error! Bookmark not defined.**

ii. Multilateral Instrument **Error! Bookmark not defined.**

iii. National Treaty Abuse Rules**Error! Bookmark not defined.**

D. Additional Tax-Related Subjects**Error! Bookmark not defined.**

i. U.S. Check-the-Box Rules**Error! Bookmark not defined.**

ii. Swiss Ruling Policy..... **Error! Bookmark not defined.**

iii. Swiss Debt-Equity Rules**Error! Bookmark not defined.**

iv. Step-up Upon Migration to Switzerland or Company Status Change....................... **Error! Bookmark not defined.**

v. F.A.T.C.A.................... **Error! Bookmark not defined.**

E. Advantages of Switzerland as a Location for a Holding Company.................................. **Error! Bookmark not defined.**

7. Netherlands............................ Error! Bookmark not defined.

A. Corporation Income Tax – General **Error! Bookmark not defined.**

B. Participation Exemption .. **Error! Bookmark not defined.**

i. In General .... **Error! Bookmark not defined.**

ii. Motive Test .... **Error! Bookmark not defined.**

iii. Subject-to-Tax Test ...... **Error! Bookmark not defined.**

iv. Asset Test..................... **Error! Bookmark not defined.**

v. Earn-Out and Balance Guarantee Arrangements .. **Error! Bookmark not defined.**

vi. Expiring Participation.. **Error! Bookmark not defined.**

vii. Non-Qualifying Participations **Error! Bookmark not defined.**

viii. Stock Options and Convertible Bonds .... **Error! Bookmark not defined.**

ix. Hybrid Loans and Profit Rights **Error! Bookmark not defined.**

x. Partitioning Reserve .... **Error! Bookmark not defined.**

C. Other Aspects .... **Error! Bookmark not defined.**

i. Costs and Expenses ..... **Error! Bookmark not defined.**

ii. Application of the at Arm's Length Principle....... **Error! Bookmark not defined.**

iii. Base Erosion .... **Error! Bookmark not defined.**

iv. Earnings Stripping .... **Error! Bookmark not defined.**

v. Hybrid Mismatches ..... **Error! Bookmark not defined.**

vi. Controlled Foreign Corporations **Error! Bookmark not defined.**

vii. Innovation Box........ **Error! Bookmark not defined.**

viii. Loss Compensation . **Error! Bookmark not defined.**

ix. Exemption from Debt Relief Income Tax .... **Error! Bookmark not defined.**

x. Liquidation Losses....... **Error! Bookmark not defined.**

xi. Tax Treaty Network ..... **Error! Bookmark not defined.**

xii. Multilateral Instrument **Error! Bookmark not defined.**

xiii. Changes in Dutch Tax Qualification Rules ...... **Error! Bookmark not defined.**

D. Tax Rulings .... **Error! Bookmark not defined.**

E. Minimum Tax Rate Act 2024 **Error! Bookmark not defined.**

F. Dividend Withholding Tax **Error! Bookmark not defined.**

i. Withholding Tax on All Dividend Payments .... **Error! Bookmark not defined.**

ii. Repurchase Facility ..... **Error! Bookmark not defined.**

iii. Additional Withholding Tax on Dividend Payments **Error! Bookmark not defined.**

G. Proposed Exit Tax .... **Error! Bookmark not defined.**

H. Conditional Withholding Tax **Error! Bookmark not defined.**

I. Extra-Territorial Taxation and Anti-Abuse Rules ..... **Error! Bookmark not defined.**

J. Capital Tax and Stamp Duties **Error! Bookmark not defined.**

8. Ireland .... Error! Bookmark not defined.

A. Recent Developments ...... **Error! Bookmark not defined.**

i. Update on Ireland's International Tax Strategy .... **Error! Bookmark not defined.**

ii. B.E.P.S. .... **Error! Bookmark not defined.**

iii. F.A.T.C.A. .... **Error! Bookmark not defined.**

iv. C.R.S. .... **Error! Bookmark not defined.**

v. State Aid Investigation **Error! Bookmark not defined.**

vi. A.T.A.D. .... **Error! Bookmark not defined.**

B. Corporate Tax Rate .... **Error! Bookmark not defined.**

C. Dividends Received by Irish Companies .... **Error! Bookmark not defined.**

#40761577v1

D. Dividends Paid by Irish Holding Companies............**Error! Bookmark not defined.**

E. Exemption from Capital Gains Tax on the Sale of Foreign Shares....................................... **Error! Bookmark not defined.**

F. Financing the Irish Holding Company – Interest Payment Deductions .... **Error! Bookmark not defined.**

G. Financing of the Irish Holding Company – Interest Withholding Tax........................ **Error! Bookmark not defined.**

H. Treaty Network .... **Error! Bookmark not defined.**

I. Capital Duty..................... **Error! Bookmark not defined.**

J. Stamp Duty on Shares...... **Error! Bookmark not defined.**

K. Liquidation Distributions by the Holding Company.**Error! Bookmark not defined.**

L. C.F.C., Thin Capitalization, and Transfer Pricing Rules **Error! Bookmark not defined.**

M. Transfer Pricing .... **Error! Bookmark not defined.**

N. Relevant Anti-Avoidance Provisions**Error! Bookmark not defined.**

O. Conclusion .... **Error! Bookmark not defined.**

9. Spain.. Error! Bookmark not defined.

A. Introduction...................... **Error! Bookmark not defined.**

B. Income Tax Treaties......... **Error! Bookmark not defined.**

C. Exemption on Qualified Domestic and Foreign-Source Income .... **Error! Bookmark not defined.**

D. Qualified Domestic and Foreign Investments...........**Error! Bookmark not defined.**

i. Minimum Stake and Holding Period**Error! Bookmark not defined.**

ii. Subject to and Not Exempt from Tax**Error! Bookmark not defined.**

iii. Economic Activity Carried Out by the Nonresident Subsidiary .... **Error! Bookmark not defined.**

E. Qualified Holding Company**Error! Bookmark not defined.**

F. Deduction of Costs........... **Error! Bookmark not defined.**

G. Capital Losses .... **Error! Bookmark not defined.**

H. Liquidation Losses........... **Error! Bookmark not defined.**

I. Exemption of E.T.V.E. Dividend Distributions.........**Error! Bookmark not defined.**

J. Capital Gains on Transfer of E.T.V.E.**Error! Bookmark not defined.**

K. Liquidation of E.T.V.E. .... **Error! Bookmark not defined.**

L. The Tax on Net Interest and Fee Margin of Certain Financial Institutions .... **Error! Bookmark not defined.**

M. Windfall Tax .... **Error! Bookmark not defined.**

N. Other Income Tax Issues.. **Error! Bookmark not defined.**

O. Corporation Income Tax .. **Error! Bookmark not defined.**

i. Rate............................. **Error! Bookmark not defined.**

ii. Interest Barrier Rule .... **Error! Bookmark not defined.**

iii. Tax Consolidation Group**Error! Bookmark not defined.**

iv. Other Nondeductible Expenses**Error! Bookmark not defined.**

v. Payments on Account Against C.I.T.**Error! Bookmark not defined.**

vi. Capital Duty................. **Error! Bookmark not defined.**

vii. Transfer Pricing....... **Error! Bookmark not defined.**

viii. Controlled Foreign Corporations**Error! Bookmark not defined.**

ix. Capitalization Reserve. **Error! Bookmark not defined.**

x. B.E.P.S. .... **Error! Bookmark not defined.**

xi. Transposition of the A.T.A.D. 2 (Hybrid Mismatches) **Error! Bookmark not defined.**

xii. Pillar Two Global Minimum Tax Rules .... **Error! Bookmark not defined.**

xiii. The European Commission's Directive Proposal on Fighting the Use of Shell Entities and Arrangements for Tax Purposes .... **Error! Bookmark not defined.**

xiv. Directive on Faster and Safer Relief of Excess Withholding Taxes ("F.A.S.T.E.R.") **Error! Bookmark not defined.**

10. Portugal.................................. Error! Bookmark not defined.

A. Corporate Income Tax System **Error! Bookmark not defined.**

i. Overview .... **Error! Bookmark not defined.**

ii. Deductible Expenses; Interest Limitation Rule .... **Error! Bookmark not defined.**

iii. Permanent Establishments **Error! Bookmark not defined.**

iv. Group Consolidation ... **Error! Bookmark not defined.**

v. Tax Neutrality Regime: Reorganizations / M&A . **Error! Bookmark not defined.**

vi. Standalone Taxation .... **Error! Bookmark not defined.**

vii. Rulings .... **Error! Bookmark not defined.**

viii. Tax Arbitration .... **Error! Bookmark not defined.**

B. Participation Exemption – Resident Holding Companies **Error! Bookmark not defined.**

C. Special Tax Regime Applicable to Collective Investment Vehicles..................................... **Error! Bookmark not defined.**

i. General .... **Error! Bookmark not defined.**

ii. Stamp Duty.................. **Error! Bookmark not defined.**

iii. Compartments............. **Error! Bookmark not defined.**

iv. M&A Operations .... **Error! Bookmark not defined.**

v. Value Added Tax.......... **Error! Bookmark not defined.**

vi. Taxation of Income Obtained in Portugal by Other E.U. Member-States Resident Collective Investment Vehicles **Error! Bookmark not defined.**

vii. Taxation of the Investors**Error! Bookmark not defined.**

viii. Real Estate Investment Trusts**Error! Bookmark not defined.**

ix. Venture Capital Funds . **Error! Bookmark not defined.**

D. Nonresident Companies... **Error! Bookmark not defined.**

i. Dividends..................... **Error! Bookmark not defined.**

ii. Capital Gains .... **Error! Bookmark not defined.**

iii. Interest and Royalties .. **Error! Bookmark not defined.**

E. Income Tax Treaties......... **Error! Bookmark not defined.**

F. M.L.I. .... **Error! Bookmark not defined.**

i. Transparent Companies **Error! Bookmark not defined.**

ii. Dual Resident Companies**Error! Bookmark not defined.**

iii. Capital Gains from Alienation of Shares or Interests of Companies Deriving Their Value Principally From Immovable Property................................ **Error! Bookmark not defined.**

G. Anti-Avoidance Measures **Error! Bookmark not defined.**

i. General Anti-Abuse Rule ("G.A.A.R.") ....**Error! Bookmark not defined.**

ii. Controlled Foreign Company ("C.F.C.") Rules....**Error! Bookmark not defined.**

iii. Blacklist of Low-Taxed Jurisdictions**Error! Bookmark not defined.**

11. United Kingdom .... Error! Bookmark not defined.

A. Introduction...................... **Error! Bookmark not defined.**

i. Individuals .... **Error! Bookmark not defined.**

ii. Corporations .... **Error! Bookmark not defined.**

B. Corporate Income Tax Rate**Error! Bookmark not defined.**

i. U.K. Companies .... **Error! Bookmark not defined.**

ii. Non-U.K. Companies .. **Error! Bookmark not defined.**

iii. Annual Tax on Enveloped Dwellings (“A.T.E.D.”) **Error! Bookmark not defined.**

iv. Disposals of U.K. Real Estate (Subject to A.T.E.D.) from April 6, 2019 .... **Error! Bookmark not defined.**

C. Dividends Received by U.K. Companies ....**Error! Bookmark not defined.**

D. Foreign Tax Credit for U.K. Companies**Error! Bookmark not defined.**

i. Source of Income......... **Error! Bookmark not defined.**

ii. Anti-Avoidance............ **Error! Bookmark not defined.**

iii. Hybrid Instruments...... **Error! Bookmark not defined.**

E. Dividends Paid by U.K. Companies to U.S. Shareholders **Error! Bookmark not defined.**

F. Diverted Profits Tax......... **Error! Bookmark not defined.**

i. Current D.P.T. Regime. **Error! Bookmark not defined.**

G. C.G.T. Exemption on the Disposal of Substantial Shareholdings............................ **Error! Bookmark not defined.**

i. The Seller’s Shareholding in the Target Company (the “Shareholding Condition”) ... **Error! Bookmark not defined.**

ii. Conditions Relating to the Trading Status of the Target Company (the “Trading Condition”)**Error! Bookmark not defined.**

H. Capital Gains on the Disposal of Shares by a Nonresident **Error! Bookmark not defined.**

I. Capital Tax and Stamp Duty**Error! Bookmark not defined.**

J. Tax Treaty Network .... **Error! Bookmark not defined.**

K. Debt Financing of U.K. Companies**Error! Bookmark not defined.**

i. The Deductibility of Interest Expense ....**Error! Bookmark not defined.**

ii. Withholding Tax on Interest**Error! Bookmark not defined.**

L. Anti-Arbitrage Legislation**Error! Bookmark not defined.**

M. Offshore Intangibles......... **Error! Bookmark not defined.**

N. C.F.C.'s .... **Error! Bookmark not defined.**

i. Background................. **Error! Bookmark not defined.**

ii. Overview of the Current Regime**Error! Bookmark not defined.**

iii. C.F.C. Rules Apply to Profits, Not Gains ....**Error! Bookmark not defined.**

O. Taxation of Foreign Branches of U.K. Companies ...**Error! Bookmark not defined.**

P. V.A.T. .... **Error! Bookmark not defined.**

Q. G.A.A.R. and Further H.M.R.C. Powers**Error! Bookmark not defined.**

i. G.A.A.R. .... **Error! Bookmark not defined.**

ii. Disclosure of Tax Avoidance Schemes ....**Error! Bookmark not defined.**

iii. D.A.C. 6 (Replaced by M.M.D.R. in the U.K.) ....**Error! Bookmark not defined.**

iv. Accelerated Payment Notices**Error! Bookmark not defined.**

v. Follower Notices .... **Error! Bookmark not defined.**

vi. Notification of Uncertain Tax Treatments ....**Error! Bookmark not defined.**

R. Corporate Criminal Offenses of Failing to Prevent the Facilitation of Tax Evasion .... **Error! Bookmark not defined.**

i. Background to the Offenses**Error! Bookmark not defined.**

ii. The Offenses................ **Error! Bookmark not defined.**

iii. Reasonable Prevention Procedures**Error! Bookmark not defined.**

iv. Territoriality................ **Error! Bookmark not defined.**

v. Distinguishing Between Tax Avoidance and Tax Evasion **Error! Bookmark not defined.**

S. F.A.T.C.A. – U.K. Implications**Error! Bookmark not defined.**

i. Background to Domestic Implementation...........**Error! Bookmark not defined.**

ii. Implementation of the I.G.A.**Error! Bookmark not defined.**

iii. Implications of the I.G.A.**Error! Bookmark not defined.**

T. The Common Reporting Standard**Error! Bookmark not defined.**

i. Background................. **Error! Bookmark not defined.**

ii. Enforcement of the C.R.S.**Error! Bookmark not defined.**

12. Belgium 217

A. Corporate Income Tax.. 220

i. General Regime 220

ii. Corporate Income Tax Rate 221

iii. Minimum Taxable Base 223

iv. Taxation of Dividends Received............................... 223

v. Taxation of Capital Gains on Shares 237

B. Withholding Tax on Dividend Distributions.................. 241

i. To Belgium 241

ii. From Belgium... 242

iii. Abuse of European Union's Directives 246

C. Tax Treatment of Borrowing and Interest Payment....... 248

i. General Expense Deduction Rule.............................. 248

ii. General Interest Limitation Rule (Arm's Length Principle) 248

iii. Interest Payments to Tax Exempt/Low Taxed Non-E.U. Residents 249

iv. E.B.I.T.D.A. Limitation Rule 251

v. Interest on Debt Pushdowns Payable at Redemption 253

vi. Special Fact Patterns related to Interest Expenses 256

vii. Withholding Tax on Outbound Interest Payments 257

D. Capital Duty 258

E. V.A.T. 258

F. Private P.R.I.C.A.F./P.R.I.V.A.K. 260

G. State Aid Investigation - Belgian Excess Profit Rulings 262

H. B.E.P.S. and F.A.T.C.A. 266

i. In General 266

ii. B.E.P.S. Action 2: Hybrid Mismatches 267

iii. B.E.P.S. Action 3: C.F.C. Rules 271

iv. B.E.P.S. Action 4: Excessive Interest Deductions 278

v. B.E.P.S. Actions 8, 9, 10, and 13: Transfer Pricing 279

vi. F.A.T.C.A. 281

vii. Pillar Two - Minimum Tax for Multinational Companies and Large Domestic Groups 282

viii. Income Tax Treaties 286

I. D.A.C.6 – Mandatory Disclosure of Aggressive Cross Border Tax Structures 289

J. A.T.A.D. 3 – Unshell Directive 292

i. First Step: Is the Entity in Scope? 293

ii. Second Step: Is the Entity at Risk? 293

iii. Third Step: What if the Entity is a Shell? 294

13. Sweden Error! Bookmark not defined.

A. In General **Error! Bookmark not defined.**

B. Participation Exemption .. **Error! Bookmark not defined.**
i. General .... **Error! Bookmark not defined.**
ii. Dividends..................... **Error! Bookmark not defined.**
iii. Capital Gains .... **Error! Bookmark not defined.**
iv. Qualifying Foreign Entities**Error! Bookmark not defined.**
C. Withholding Tax............... **Error! Bookmark not defined.**
i. Outbound Dividends.... **Error! Bookmark not defined.**
ii. Inbound Dividends ...... **Error! Bookmark not defined.**
iii. Treaty Chart................. **Error! Bookmark not defined.**
iv. Proposed Revised Swedish W.H.T. Act................**Error! Bookmark not defined.**
D. Financing .... **Error! Bookmark not defined.**
i. Loan Financing............ **Error! Bookmark not defined.**
ii. Equity Contributions ... **Error! Bookmark not defined.**
E. Liquidation....................... **Error! Bookmark not defined.**
i. Distributions .... **Error! Bookmark not defined.**
ii. Losses .... **Error! Bookmark not defined.**
F. Net Operating Losses....... **Error! Bookmark not defined.**
G. Transfer Pricing .... **Error! Bookmark not defined.**
H. Controlled Foreign Corporations**Error! Bookmark not defined.**
I. B.E.P.S. .... **Error! Bookmark not defined.**
J. Risk Tax on Credit Institutions**Error! Bookmark not defined.**
14. Denmark .... Error! Bookmark not defined.
A. Introduction...................... **Error! Bookmark not defined.**
B. Corporation Income Tax .. **Error! Bookmark not defined.**
C. Deductible Expenses........ **Error! Bookmark not defined.**
D. Withholding Tax............... **Error! Bookmark not defined.**

#40761577v1

i. Outbound Dividends.... **Error! Bookmark not defined.**

ii. Interest .... **Error! Bookmark not defined.**

iii. Royalties .... **Error! Bookmark not defined.**

E. Taxation of Inbound Dividends**Error! Bookmark not defined.**

i. Anti-Tax Avoidance Provision**Error! Bookmark not defined.**

F. C.F.C. Taxation .... **Error! Bookmark not defined.**

i. Scope and Conditions of Applicability ....**Error! Bookmark not defined.**

ii. Recapture of C.F.C. Taxation**Error! Bookmark not defined.**

G. Capital Gains Taxation..... **Error! Bookmark not defined.**

i. Domestic Subsidiaries . **Error! Bookmark not defined.**

H. Interest Deductibility Limitations**Error! Bookmark not defined.**

i. Thin Capitalization ...... **Error! Bookmark not defined.**

ii. Asset Limitation Rule.. **Error! Bookmark not defined.**

iii. E.B.I.T.D.A. .... **Error! Bookmark not defined.**

I. Taxation of Payments to Noncooperative Tax Jurisdictions **Error! Bookmark not defined.**

J. Base and Erosion Profit Shifting (“B.E.P.S.”) ....**Error! Bookmark not defined.**

K. General Anti-Abuse Rule. **Error! Bookmark not defined.**

L. Hybrid Mismatches.......... **Error! Bookmark not defined.**

M. Transfer Pricing .... **Error! Bookmark not defined.**

i. Documentation .... **Error! Bookmark not defined.**

N. Fiscal Consolidation/Group Treatment**Error! Bookmark not defined.**

i. Mandatory Local Tax Consolidation**Error! Bookmark not defined.**

ii. Optional Cross-Border Tax Consolidation .... **Error! Bookmark not defined.**

iii. Partial Abandonment of the Principle of Worldwide Income Taxation.................... **Error! Bookmark not defined.**

O. Tax Ruling Practice.......... **Error! Bookmark not defined.**

i. Informal Ruling .... **Error! Bookmark not defined.**

ii. Binding Ruling .... **Error! Bookmark not defined.**

iii. Other Approval Procedures**Error! Bookmark not defined.**

P. Pillar Two......................... **Error! Bookmark not defined.**

15. Finland .... Error! Bookmark not defined.

A. General............................. **Error! Bookmark not defined.**

B. Finland's Tax Treaties ...... **Error! Bookmark not defined.**

C. Taxation of Income from a Finnish Limited Liability Company .... **Error! Bookmark not defined.**

i. Withholding Tax on Outbound Dividend Distributions **Error! Bookmark not defined.**

ii. Withholding Tax on Outbound Interest Payments **Error! Bookmark not defined.**

iii. Capital Gains Taxation **Error! Bookmark not defined.**

iv. Dissolution.................. **Error! Bookmark not defined.**

D. Corporate Income Taxation of Finnish Limited Liability Companies .... **Error! Bookmark not defined.**

i. General .... **Error! Bookmark not defined.**

ii. Participation Exemption for Dividend Income..... **Error! Bookmark not defined.**

iii. Participation Exemption for Capital Gains........... **Error! Bookmark not defined.**

iv. Interest Deduction Limitations**Error! Bookmark not defined.**

v. Group Contribution Regime**Error! Bookmark not defined.**

vi. Net Operating Losses .. **Error! Bookmark not defined.**

vii. Deduction for Final Losses of an E.E.A. Subsidiary **Error! Bookmark not defined.**

viii. Controlled Foreign Corporations**Error! Bookmark not defined.**

E. Transfer Tax .... **Error! Bookmark not defined.**

F. Value Added Taxation...... **Error! Bookmark not defined.**

G. Transfer Pricing .... **Error! Bookmark not defined.**

H. Advance Processes........... **Error! Bookmark not defined.**

I. Recent Developments ...... **Error! Bookmark not defined.**

i. Global Minimum Tax .. **Error! Bookmark not defined.**

ii. B.E.P.S. and Tax Policy **Error! Bookmark not defined.**

16. Austria..................................... Error! Bookmark not defined.

A. In General .... **Error! Bookmark not defined.**

B. Capitalization of Austrian Companies**Error! Bookmark not defined.**

i. Equity .... **Error! Bookmark not defined.**

ii. Debt .... **Error! Bookmark not defined.**

iii. Thin Capitalization ...... **Error! Bookmark not defined.**

C. Corporate Income Taxation**Error! Bookmark not defined.**

i. Resident Companies .... **Error! Bookmark not defined.**

ii. Nonresident Companies**Error! Bookmark not defined.**

iii. Participation Exemption**Error! Bookmark not defined.**

iv. Controlled Foreign Corporation ("C.F.C.") Rules **Error! Bookmark not defined.**

v. Switch-Over Rule Regarding Participations.........**Error! Bookmark not defined.**

vi. Group Taxation .... **Error! Bookmark not defined.**

vii. Transfer Pricing....... **Error! Bookmark not defined.**

D. Withholding Tax on Outbound Payments ....**Error! Bookmark not defined.**

i. Dividends.................... **Error! Bookmark not defined.**

ii. Capital Gains .... **Error! Bookmark not defined.**

iii. Royalties .... **Error! Bookmark not defined.**

iv. Interest .... **Error! Bookmark not defined.**

v. Other Income .... **Error! Bookmark not defined.**

E. Other Tax Issues............... **Error! Bookmark not defined.**

i. Wealth Tax .... **Error! Bookmark not defined.**

ii. Value Added Tax.......... **Error! Bookmark not defined.**

iii. Real Estate Transfer Tax**Error! Bookmark not defined.**

iv. Stamp Duty .... **Error! Bookmark not defined.**

v. Tax Rulings.................. **Error! Bookmark not defined.**

vi. The General Anti-Avoidance Rule ("G.A.A.R.") .**Error! Bookmark not defined.**

vii. Notification Obligation Regarding Reportable Cross-Border Arrangements .... **Error! Bookmark not defined.**

viii. Hybrid Mismatch Rules**Error! Bookmark not defined.**

ix. Foreign Tax Credit....... **Error! Bookmark not defined.**

F. Minimum Tax (Pillar Two)**Error! Bookmark not defined.**

17. France .... Error! Bookmark not defined.

A. Corporation Income Tax – General**Error! Bookmark not defined.**

B. Net Operating Losses....... **Error! Bookmark not defined.**

i. Carryforward .... **Error! Bookmark not defined.**

ii. Carryback .... **Error! Bookmark not defined.**

C. Tax Consolidation .... **Error! Bookmark not defined.**

i. Scope and Conditions .. **Error! Bookmark not defined.**

ii. Computation of the Group Taxable Result ....**Error! Bookmark not defined.**

iii. Specific Group Provisions**Error! Bookmark not defined.**

D. Taxation of Tax Transparent Entities**Error! Bookmark not defined.**

E. Foreign Tax Credits.......... **Error! Bookmark not defined.**

F. Taxation of Dividends...... **Error! Bookmark not defined.**

i. Taxation of Inbound Distribution – The Dividends Received Deduction ("D.R.D.")**Error! Bookmark not defined.**

ii. Withholding Tax on Outbound Dividends...........**Error! Bookmark not defined.**

G. Tax Treatment to Outbound Dividends Paid to Companies Located in the E.U. .... **Error! Bookmark not defined.**

i. E.U. Directive Exemption**Error! Bookmark not defined.**

ii. 5% E.U. Exemption..... **Error! Bookmark not defined.**

iii. Outbound Dividends and Tax Treaties ....**Error! Bookmark not defined.**

iv. Branch Tax.................. **Error! Bookmark not defined.**

H. Taxation of Interest .... **Error! Bookmark not defined.**

i. Deductibility of Interest Charges**Error! Bookmark not defined.**

ii. Withholding Tax on Interest – Exemptions ....**Error! Bookmark not defined.**

I. Taxation of Remuneration of Services and for Royalties on I.P. **Error! Bookmark not defined.**

i. Taxation of Outbound Payments**Error! Bookmark not defined.**

ii. Taxation of Inbound Payments for Services.........**Error! Bookmark not defined.**

iii. Taxation of Inbound Royalties - Industrial Property ("I.P.") Box Regime .... **Error! Bookmark not defined.**

iv. Eligible Intangible Assets**Error! Bookmark not defined.**

v. Application of the Nexus Approach **Error! Bookmark not defined.**

vi. Safeguard Clause for Exceptional Circumstances **Error! Bookmark not defined.**

vii. Filing Obligations.... **Error! Bookmark not defined.**

J. Taxation of Capital Gains **Error! Bookmark not defined.**

i. Territoriality................ **Error! Bookmark not defined.**

ii. C.G.T. on Company Shareholdings **Error! Bookmark not defined.**

iii. C.G.T. on Real Estate Holding Companies .... **Error! Bookmark not defined.**

iv. C.G.T. on Venture Capital Vehicles **Error! Bookmark not defined.**

v. C.G.T. on Short-Term Shareholdings – Anti-Abuse Provision for Intercompany Transactions **Error! Bookmark not defined.**

K. 8% Tax on Share Buybacks **Error! Bookmark not defined.**

L. Anti-Avoidance Provisions **Error! Bookmark not defined.**

i. General Anti-Avoidance Provisions **Error! Bookmark not defined.**

ii. Other Specific Anti-Abuse Provisions................. **Error! Bookmark not defined.**

M. Other Tax Items................ **Error! Bookmark not defined.**

i. Cooperation with the Tax Authorities **Error! Bookmark not defined.**

ii. Fraud Act .... **Error! Bookmark not defined.**

iii. Advisor's Disclosure and Penalties **Error! Bookmark not defined.**

iv. Transfer Pricing .... **Error! Bookmark not defined.**

v. Transfer Taxes .... **Error! Bookmark not defined.**

N. B.E.P.S., A.T.A.D., and France **Error! Bookmark not defined.**

i. B.E.P.S. .... **Error! Bookmark not defined.**

ii. A.T.A.D. .... **Error! Bookmark not defined.**

iii. Proposal for A.T.A.D 3 **Error! Bookmark not defined.**

18. Italy .... Error! Bookmark not defined.

A. Corporate Tax Rate .... **Error! Bookmark not defined.**

B. Global Minimum Tax....... **Error! Bookmark not defined.**

C. Dividend Exemption .... **Error! Bookmark not defined.**

i. Domestic Dividends .... **Error! Bookmark not defined.**

ii. Foreign Dividends .... **Error! Bookmark not defined.**

D. Participation Exemption for Gains**Error! Bookmark not defined.**

E. Interest Deduction............ **Error! Bookmark not defined.**

F. Minimum Taxable Income for Non-Operating Companies **Error! Bookmark not defined.**

G. Allowance for Corporate Equity**Error! Bookmark not defined.**

H. Group Consolidation........ **Error! Bookmark not defined.**

i. Domestic Consolidation**Error! Bookmark not defined.**

ii. Worldwide Consolidation**Error! Bookmark not defined.**

I. C.F.C. Legislation .... **Error! Bookmark not defined.**

J. Treaty Protection.............. **Error! Bookmark not defined.**

K. Withholding Taxes on Outbound Payments..............**Error! Bookmark not defined.**

i. Dividend Withholding – Domestic Law...............**Error! Bookmark not defined.**

ii. Parent-Subsidiary Directive**Error! Bookmark not defined.**

iii. Interest and Royalties .. **Error! Bookmark not defined.**

iv. Shell Entities................ **Error! Bookmark not defined.**

v. Nonresident Company with a Permanent Establishment **Error! Bookmark not defined.**

vi. Nonresident Company with No Permanent Establishment........................ **Error! Bookmark not defined.**

L. Branch Exemption Regime**Error! Bookmark not defined.**

M. Foreign Tax Credit........... **Error! Bookmark not defined.**

N. Transfer Pricing .... **Error! Bookmark not defined.**

O. New Patent Box Regime.. **Error! Bookmark not defined.**

P. Automatic Exchange of Information**Error! Bookmark not defined.**

Q. Italian Measures to Combat B.E.P.S.**Error! Bookmark not defined.**

R. Tax Regime for Holding Companies Classified as S.I.C.A.F.'s................................ **Error! Bookmark not defined.**

19. Germany .... Error! Bookmark not defined.

A. Introduction...................... **Error! Bookmark not defined.**

B. General Taxation of German Corporate Entities.......**Error! Bookmark not defined.**

C. General Participation and Dividend Exemption ....**Error! Bookmark not defined.**

i. Background.................. **Error! Bookmark not defined.**

ii. Participation Exemption**Error! Bookmark not defined.**

iii. Dividend Exemption.... **Error! Bookmark not defined.**

iv. Financing Expenses..... **Error! Bookmark not defined.**

D. Trade Tax Add-Backs and Deductions**Error! Bookmark not defined.**

E. Earnings Stripping Rules . **Error! Bookmark not defined.**

i. General Concept.......... **Error! Bookmark not defined.**

ii. Exemptions.................. **Error! Bookmark not defined.**

F. Restricting Tax Deductions on License Payments....**Error! Bookmark not defined.**

G. Loss Carryforward........... **Error! Bookmark not defined.**

H. Real Estate Transfer Tax on Share Transfer Transactions **Error! Bookmark not defined.**

I. C.F.C. Taxation .... **Error! Bookmark not defined.**

J. Dividend Withholding Tax; Treaty Network; Anti-Abuse Provisions................................. **Error! Bookmark not defined.**

i. Withholding Tax .... **Error! Bookmark not defined.**

ii. Treaty Network............ **Error! Bookmark not defined.**

iii. Anti-Abuse Provisions. **Error! Bookmark not defined.**

K. Transfer Pricing .... **Error! Bookmark not defined.**

i. German Administrative Principles**Error! Bookmark not defined.**

ii. Transfer of Functions... **Error! Bookmark not defined.**

iii. Documentation Requirements**Error! Bookmark not defined.**

L. German Investment Tax Law**Error! Bookmark not defined.**

M. Transparency Register...... **Error! Bookmark not defined.**

20. Cyprus..................................... Error! Bookmark not defined.

A. General............................. **Error! Bookmark not defined.**

B. Income Tax....................... **Error! Bookmark not defined.**

i. Tax Rate....................... **Error! Bookmark not defined.**

ii. Basic Concept.............. **Error! Bookmark not defined.**

iii. Residence..................... **Error! Bookmark not defined.**

C. E.U. Anti-Tax Avoidance Directive (A.T.A.D. 1 and A.T.A.D. 2) .... **Error! Bookmark not defined.**

D. Exit Taxation Rules.......... **Error! Bookmark not defined.**

E. Hybrid Mismatch Rules ... **Error! Bookmark not defined.**

F. Reverse Hybrid Mismatches**Error! Bookmark not defined.**

G. Cap on Interest Expense .. **Error! Bookmark not defined.**

H. Controlled Foreign Company ("C.F.C.") Rules........**Error! Bookmark not defined.**

I. General Anti-Abuse ("G.A.A.R.") Rule**Error! Bookmark not defined.**

#40761577v1

J. Permanent Establishments **Error! Bookmark not defined.**

K. Notional Interest Deduction ("N.I.D.") on Equity ....**Error! Bookmark not defined.**

i. Former Provisions .... **Error! Bookmark not defined.**

ii. Provisions Currently in Effect**Error! Bookmark not defined.**

iii. Anti-Avoidance Provisions**Error! Bookmark not defined.**

iv. Practical Uses .... **Error! Bookmark not defined.**

L. Expansion of the Definition of the Republic of Cyprus **Error! Bookmark not defined.**

M. Tax Losses Group Relief.. **Error! Bookmark not defined.**

N. Reorganization of Companies and Anti-Avoidance Provisions................................. **Error! Bookmark not defined.**

O. New Transfer Pricing Regulations**Error! Bookmark not defined.**

i. Local File.................... **Error! Bookmark not defined.**

ii. Master File.................. **Error! Bookmark not defined.**

iii. Summary Information Table**Error! Bookmark not defined.**

P. D.A.C. 6 Implementation in Cyprus**Error! Bookmark not defined.**

i. General Considerations **Error! Bookmark not defined.**

ii. Continued Application of Other Directives ....**Error! Bookmark not defined.**

iii. Basics Adopted by Cyprus**Error! Bookmark not defined.**

iv. Definition of Intermediaries**Error! Bookmark not defined.**

v. Further Cyprus Considerations**Error! Bookmark not defined.**

Q. U.B.O. Registers .... **Error! Bookmark not defined.**

i. Multiple Registers .... **Error! Bookmark not defined.**

ii. Definition of Beneficial Owner **Error! Bookmark not defined.**

iii. Information to be Filed at the Registrar of Companies **Error! Bookmark not defined.**

R. Specific Income Tax Benefits **Error! Bookmark not defined.**

i. Shipping...................... **Error! Bookmark not defined.**

ii. Intellectual Property .... **Error! Bookmark not defined.**

S. Specific Allowances and Deductions **Error! Bookmark not defined.**

T. Loan Interest .... **Error! Bookmark not defined.**

U. Anti-Avoidance Provisions for Hybrid Instruments and Artificial Transactions for Dividends **Error! Bookmark not defined.**

V. Special Contribution for the Defense of the Republic **Error! Bookmark not defined.**

i. Scope of Levy............. **Error! Bookmark not defined.**

ii. Penalties...................... **Error! Bookmark not defined.**

W. Other Taxes .... **Error! Bookmark not defined.**

i. Capital Gains Tax .... **Error! Bookmark not defined.**

ii. Transactions Between Related Parties................. **Error! Bookmark not defined.**

iii. Inheritance and Estate Taxes **Error! Bookmark not defined.**

iv. Thin Capitalization Rules **Error! Bookmark not defined.**

X. Arm's Length Transfer Pricing **Error! Bookmark not defined.**

Y. Tax Registration Provisions **Error! Bookmark not defined.**

Z. Exchange of Information and Bank Confidentiality Rules **Error! Bookmark not defined.**

AA. Provision of Information by Civil Servants .... **Error! Bookmark not defined.**

BB. Bookkeeping and Field Audits **Error! Bookmark not defined.**

CC. More Stringent Requirements from the E.U. and Other Jurisdictions .... **Error! Bookmark not defined.**

DD. Double Tax Treaties .... **Error! Bookmark not defined.**

i. In General .... **Error! Bookmark not defined.**

ii. Cyprus-U.K. Income Tax Treaty **Error! Bookmark not defined.**

EE. The B.E.P.S. Project – Implications for Cyprus .... **Error! Bookmark not defined.**

i. B.E.P.S. Action 2 (Hybrid Mismatches) .... **Error! Bookmark not defined.**

ii. B.E.P.S. Action 3 (Effective C.F.C. Rules) .... **Error! Bookmark not defined.**

iii. B.E.P.S. Action 4 (Interest Deductions) .... **Error! Bookmark not defined.**

iv. B.E.P.S. Actions 5 (Transparency and Substance) **Error! Bookmark not defined.**

v. B.E.P.S. Action 10 (Arm's Length Transfer Pricing – Profit Split Method) .... **Error! Bookmark not defined.**

vi. B.E.P.S. Action 13 (Transfer Pricing Documentation) **Error! Bookmark not defined.**

vii. B.E.P.S. Action 15 ... **Error! Bookmark not defined.**

FF. Global Minimum Tax (Pillar Two) Implementation . **Error! Bookmark not defined.**

GG. Taxation of Dividends, Interest and Royalties Earned by Companies in E.U.-listed Noncooperative Jurisdictions and Low-Tax Jurisdictions .... **Error! Bookmark not defined.**

21. Malta .... Error! Bookmark not defined.

A. General Overview of Business Forms and Responsibilities **Error! Bookmark not defined.**

i. Forms of Business .... **Error! Bookmark not defined.**

ii. Capital Contribution Taxes **Error! Bookmark not defined.**

iii. Governance and Responsibilities **Error! Bookmark not defined.**

iv. Audit Requirements..... **Error! Bookmark not defined.**

v. Specific Industry Incentives **Error! Bookmark not defined.**

vi. Taxation of Company Profits **Error! Bookmark not defined.**

B. Tax Accounting .... **Error! Bookmark not defined.**

C. Maltese Refundable Tax System **Error! Bookmark not defined.**

i. Six-Sevenths Refund ... **Error! Bookmark not defined.**

ii. Five-Sevenths Refund . **Error! Bookmark not defined.**

iii. Full Refund................. **Error! Bookmark not defined.**

D. European Compliance...... **Error! Bookmark not defined.**

E. Participation Exemption .. **Error! Bookmark not defined.**

F. Other Exemptions .... **Error! Bookmark not defined.**

i. Permanent Establishment **Error! Bookmark not defined.**

ii. Intellectual Property .... **Error! Bookmark not defined.**

G. Withholding Taxes on Dividends Distributed........... **Error! Bookmark not defined.**

H. Withholding Taxes on Interest Paid **Error! Bookmark not defined.**

I. Withholding Taxes on Royalties Paid **Error! Bookmark not defined.**

J. Transfers of Shares in a Maltese Company.............. **Error! Bookmark not defined.**

K. Double Taxation Relief .... **Error! Bookmark not defined.**

i. Treaty Relief................ **Error! Bookmark not defined.**

ii. Unilateral Relief .... **Error! Bookmark not defined.**

iii. Flat Rate Foreign Tax Credit**Error! Bookmark not defined.**

L. B.E.P.S. and Other Initiatives**Error! Bookmark not defined.**

M. Patent Box Regime .... **Error! Bookmark not defined.**

N. Conclusions Applicable to Malta**Error! Bookmark not defined.**

1. CHART

The following chart is a summary of several of the most common tax regimes that are covered in detail in this text. Below is a brief explanation of what information is shown in each row. For an in-depth discussion of a country's rules, refer to its respective section.

- **Corporate Income Tax ("C.I.T."); V.A.T.** The standard effective rate is shown, with notations.

- **Participation Exemption ("P/E").** Whether a full or partial exemption is provided for dividends and capital gains is shown. For a discussion of minimum requirements, refer to the country's respective section.

- **Dividends Paid.** Regarding withholding tax levied on dividends paid by a holding company to a nonresident shareholder, three rates are discussed: the P.S.D. rate, the regular withholding rate, and treaty rates.

- **Dividends Received; Capital Gains.** Regarding capital gains and dividends received by a holding company, two rates are shown: the exemption provided under the participation exemption, if applicable, and the regular rate.

- **Double Tax Relief; Tax Treaties.** The size of the treaty network and types of relief available are shown.

- **Diverted Profits Tax ("D.P.T.").** Whether this tax is present, and the rate if so, is shown.

- **Debt vs. Equity.** The type of regulations is shown – thin capitalization rules or a general limitation on interest payments – as well as the ratio or cap on E.B.I.T.D.A.

- **Capital Tax/Stamp Duty; C.F.C. Rules; Patent Box; Transfer Pricing; G.A.A.R./P.P.T.; Hybrid Mismatch Rules; Exit Tax.** Whether regulations are in place is shown.

	Austria	**Belgium**
C.I.T.	23%[i]	25%[ii]
P/E (Div./C.G.)	Full / Full	Full / Full
Dividends Paid	0% / 27.5% / treaty rate[iii]	0% / 30% / treaty rate
Dividends Received	Full / 23%	Full / 25%
Capital Gains	Full / 23%	P/E / 25%[iv]
Double Tax Relief	D.T.T.; Exempt/Credit[v]	D.T.T.; Credit[vi]
Tax Treaties	89	95
V.A.T.	20%	21%
Cap. Tax / Stamp Duty	No / Yes	No / Yes
D.P.T.	No	No
C.F.C. Rules	Yes	Yes
Debt vs. Equity	Interest limitation based on A.T.A.D.	5:1 / Gen. Limit[vii]
Transfer Pricing	Based on O.E.C.D. rules	Based on O.E.C.D. rules
Patent Box	No	Yes
G.A.A.R. / P.P.T.	Both	Both
Hybrid Mismatch	Yes	Yes
Exit Tax	Yes	Yes

	Cyprus	Denmark
C.I.T.	12.5%	22%
P/E (Div./C.G.)	Full / Full[viii]	Full / Full
Dividends Paid	0%	0% / 15% / 22% / treaty rate[ix]
Dividends Received	Generally exempt[x]	Full[xi]
Capital Gains	Full / 20%[xii]	Full / 22%[xiii]
Double Tax Relief	D.T.T.; Credit[xiv]	D.T.T.; Credit
Tax Treaties	67	84
V.A.T.	19%	25%
Cap. Tax / Stamp Duty	Yes[xv] / Yes[xvi]	No / No
D.P.T.	No[xvii]	No
C.F.C. Rules	Yes	Yes
Debt vs. Equity	Interest limitation based on A.T.A.D.	4:1 / Asset Basis / Tax E.B.I.T.D.A.[xviii]
Transfer Pricing	Based on O.E.C.D. rules[xix]	Based on O.E.C.D. rules
Patent Box	Yes[xx]	No
G.A.A.R. / P.P.T.	Both	Both
Hybrid Mismatch	Yes	Yes
Exit Tax	Yes	Yes

	France	**Finland**
C.I.T.	25%[xxi]	20%[xxii]
P/E (Div./C.G.)	Partial / Partial	Full / Full
Dividends Paid	0% / C.I.T. rate / treaty rate[xxiii]	0% / 20% (30%) / treaty rate[xxiv]
Dividends Received	1.25% / C.I.T. rate[xxv]	Full / 20%
Capital Gains	3% / C.I.T. rate[xxvi]	Full / 20%
Double Tax Relief	D.T.T.; Credit[xxvii]	D.T.T.; Exemption, Credit
Tax Treaties	120+	80[xxviii]
V.A.T.	20%	25.5%
Cap. Tax / Stamp Duty	Yes / Yes	No / Yes
D.P.T.	No	No
C.F.C. Rules	Yes[xxix]	Yes
Debt vs. Equity	Gen. limit[xxx] 1.5:1 Thin-cap ratio[xxxi]	General interest deduction limitations
Transfer Pricing	Based on O.E.C.D. rules	Based on O.E.C.D. rules
Patent Box	Yes (nexus approach)	No
G.A.A.R. / P.P.T.	Both	Both
Hybrid Mismatch	Yes	Yes
Exit Tax	No	Yes

	Germany	Ireland
C.I.T.	~30%[xxxii]	12.5% or 25%[xxxiii]
P/E (Div./C.G.)	Partial / Partial	Full / Full
Dividends Paid	0% / 26.38% / treaty rate[xxxiv]	0% / 25% / treaty rate
Dividends Received	95% / ~30%	Full / 12.5% or 25%[xxxv]
Capital Gains	95% / ~30%	Full / 33%
Double Tax Relief	D.T.T.; Credit; Deduction	D.T.T.; Credit; Deduction
Tax Treaties	97	78
V.A.T.	19%[xxxvi]	23%
Cap. Tax / Stamp Duty	No / No[xxxvii]	No / Yes
D.P.T.	No	No
C.F.C. Rules	Yes	Yes
Debt vs. Equity	Gen. limit on interest[xxxviii]	No thin cap. / Gen. limit[xxxix]
Transfer Pricing	Based on O.E.C.D. rules	Based on O.E.C.D. rules[xl]
Patent Box	No[xli]	Yes[xlii]
G.A.A.R. / P.P.T.	Both	Both
Hybrid Mismatch	Yes	Yes
Exit Tax	Yes	Yes

	Italy	Luxembourg
C.I.T.	24%	24.94%[xliii]
P/E (Div./C.G.)	Partial / Partial[xliv]	Full / Full
Dividends Paid	0%[xlv] / 26% / treaty rate	0% / 15% / treaty rate
Dividends Received	95% Exempt / 24%	Full / 17%+[xlvi]
Capital Gains	95% Exempt / 24%	Full / 17%+[xlvii]
Double Tax Relief	D.T.T.; Credit[xlviii]	D.T.T.; Credit; Deduction[xlix]
Tax Treaties	104	85
V.A.T.	22%	17%
Cap. Tax / Stamp Duty	Yes / Yes	Yes / Yes
D.P.T.	No	No
C.F.C. Rules	Yes	Yes
Debt vs. Equity	Gen. limit on interest[l]	No thin cap. / Gen. limit on interest [li]
Transfer Pricing	Based on O.E.C.D. rules	Based on O.E.C.D. rules
Patent Box	Yes[lii]	Yes
G.A.A.R. / P.P.T.	Both	Both
Hybrid Mismatch	Yes	Yes
Exit Tax	Yes	Yes

	Malta	**Netherlands**
C.I.T.	35%	19% / 25.8% (over €200,000)
P/E (Div./C.G.)	Full / Full[liii]	Full / Full
Dividends Paid	0% / none / treaty rate	0% / 15% / treaty rate[liv]
Dividends Received	Full / 35%	Full / 25.8% / 19%
Capital Gains	Full / 35%	Full / 25.8% / 19%
Double Tax Relief	D.T.T.; Credits	D.T.T.; Credit; Exemption[lv]
Tax Treaties	81	97
V.A.T.	18%[lvi]	21% / 9%
Cap. Tax / Stamp Duty	Yes[lvii] / Yes	No / No
D.P.T.	No	No
C.F.C. Rules	Yes (A.T.A.D.)	Yes
Debt vs. Equity	Yes (A.T.A.D.)	No thin cap. / Gen. limit[lviii]
Transfer Pricing	Based on O.E.C.D. rules	Based on O.E.C.D. rules
Patent Box	Yes[lix]	Yes[lx]
G.A.A.R. / P.P.T.	Both	Both
Hybrid Mismatch	Yes	Yes
Exit Tax	Yes	No

	Portugal	Spain
C.I.T.	20%[lxi]	25%
P/E (Div./C.G.)	Full / Full[lxii]	Partial / Partial
Dividends Paid	0% / 25% / treaty rate[lxiii]	0% / 19% / treaty rate[lxiv]
Dividends Received	P/E / 25%	Partial / 25%
Capital Gains	P/E / 25%	Partial / 25%
Double Tax Relief	78 Treaties / F.T.C.[lxv]	D.T.T.; Credit; Exemption[lxvi]
Tax Treaties	78	96[lxvii]
V.A.T.	23%	21% / 10%/ 4%
Cap. Tax / Stamp Duty	No / Yes	Yes / Yes
D.P.T.	No	No
C.F.C. Rules	Yes	Yes
Debt vs. Equity	Interest Limitation Rule / Notional Interest Deduction[lxviii]	Gen. limit on interest[lxix]
Transfer Pricing	Based on O.E.C.D. rules	Based on O.E.C.D. rules
Patent Box	Yes	Yes[lxx]
G.A.A.R. / P.P.T.	Both	Both
Hybrid Mismatch	Yes	Yes
Exit Tax	Yes	Yes

	Sweden	**Switzerland**
C.I.T.	20.6%	11.82% to 22.30%[lxxi]
P/E (Div./C.G.)	Full / Full	Partial / Partial[lxxii]
Dividends Paid	0% / 30% / treaty rate[lxxiii]	n/a / 35% / treaty rate[lxxiv]
Dividends Received	Full / 30%	P/E / 11.82% to 22.30%[lxxv]
Capital Gains	Full / 20.6%	P/E / 11.82% to 22.30%[lxxvi]
Double Tax Relief	D.T.T.; Credit; Deduction	D.T.T.; Exempt; Deduction
Tax Treaties	92	>100
V.A.T.	25%[lxxvii]	8.1%[lxxviii]
Cap. Tax / Stamp Duty	No / Yes[lxxix]	Yes / Yes
D.P.T.	No	No
C.F.C. Rules	Yes	No
Debt vs. Equity	No thin cap. rules[lxxx]	Generally, 70-85% of debt
Transfer Pricing	Based on O.E.C.D. rules	Based on O.E.C.D. rules
Patent Box	No	Yes[lxxxi]
G.A.A.R. / P.P.T.	Both	Yes
Hybrid Mismatch	Yes	Proposed
Exit Tax	Yes	No

	U.K.
C.I.T.	25%
P/E (Div./C.G.)	Full / Full[lxxxii]
Dividends Paid	0% / none / treaty rate[lxxxiii]
Dividends Received	Full / 25%[lxxxiv]
Capital Gains	Full / 25%[lxxxv]
Double Tax Relief	D.T.T.; Credit; Deduction
Tax Treaties	>130
V.A.T.	20%
Cap. Tax / Stamp Duty	No / Yes
D.P.T.	31%
C.F.C. Rules	Yes
Debt vs. Equity	Gen. limit on interest[lxxxvi]
Transfer Pricing	Based on O.E.C.D. rules
Patent Box	Yes[lxxxvii]
G.A.A.R. / P.P.T.	Both
Hybrid Mismatch	Yes
Exit Tax	Yes

A. Notes

---

i *Austria (C.I.T.)*. A minimum corporate income tax is levied.

ii *Belgium (C.I.T.)*. Under certain conditions, qualifying small and medium-sized enterprises may benefit from a reduced rate of 20% for the first €100,000 of taxable income.

iii *Austria (Dividends Paid)*. Under most tax treaties, withholding tax is ordinarily reduced to 15% for portfolio dividends and 5% for non-portfolio dividends. In some cases, withholding tax may be eliminated entirely.

iv *Belgium (Capital Gains)*. Capital gains on shares are either taxed at the standard corporate income tax rate (25%) if one or more of the conditions are not met, or fully exempt (0%) if all conditions are met.

v *Austria (Double Tax Relief)*. Varies by treaty. See "Tax Treaty Network" for a list of countries that have a tax treaty with Austria. Unilateral relief exemption by progression, foreign tax credit.

vi *Belgium (Double Tax Relief)*. Varies by treaty. See “Tax Treaty Network” for a list of countries that have a tax treaty with Belgium. Treaty relief is mandatory. For unilateral relief, fixed credit may be available (subject to limitations) for interest or royalties, not for dividends; D.R.D. for qualifying dividends and exemption for qualifying capital gains on shares.

vii *Belgium (Debt vs. Equity)*. There is no deduction for net interest in excess of the higher of (i) €3,000,000 or (ii) 30% of tax E.B.I.T.D.A. (as defined). For Belgian group of companies (as defined), the €3,000,000 threshold applies on a consolidated basis.

viii *Cyprus (P/E)*. The exemption does not apply where the company paying the dividend engages directly or indirectly more than 50% in activities which lead to investment income and the foreign tax burden on such income is substantially lower than the Cyprus tax burden. The exemption does not apply also to the extent that such dividends are deductible for purposes of calculating the taxable income of the dividend paying company.

ix *Denmark (Dividends Paid)*. If a dividend is not covered by the P.S.D., it is subject to 22% withholding. However, a refund will be provided if this rate is reduced by a treaty or if a tax information exchange treaty has been entered into between Denmark and the jurisdiction in which the recipient resides for tax purposes and certain other criteria are met), in which case a 15% rate applies.

x *Cyprus (Dividends Received)*. Specific conditions apply. A 17% special defense contribution applies to Cypriot individuals.

xi *Denmark (Dividends Received)*. Dividends may be exempt even if below the 10% participation exemption ownership requirement for consolidated groups.

xii *Cyprus (Capital Gains)*. A 20% tax rate applies for real estate situated in Cyprus.

xiii *Denmark (Capital Gains)*. Exemptions also apply to consolidated groups and unlisted companies that are not part of a consolidated group and not covered by the participation exemption.

xiv *Cyprus (Double Tax Relief)*. Treaty relief varies by treaty. See "Tax Treaty Network" for a list of countries that have a tax treaty with Cyprus. Unilateral relief is based on a foreign tax credit, credit against income tax, and the Special Defense Contribution for foreign taxes paid.

xv *Cyprus (Capital Tax)*. Capital tax is not applied except on real estate within Cyprus.

xvi *Cyprus (Stamp Duty)*. Stamp duty applies to all transactions whether effected abroad or in Cyprus. The document must relate to property located in Cyprus, a matter related to Cyprus, or a transaction to be performed in Cyprus. Rates are graduated, and the minimum value of the transaction is €5,000.

xvii *Cyprus (D.P.T.)*. Implementation of a diverted profits tax is under discussion.

xviii *Denmark (Debt vs. Equity)*. Under the Asset Limitation Rule, net financing expenses exceeding DKK 21,300,000 are capped at 2.9% of the tax basis of operating assets. Under the E.B.I.T.D.A. Limitation Rule, net excess debt funding costs exceeding DKK 22,313,400 are capped at 30% of E.B.I.T.D.A. A higher percentage can be elected if the consolidated group excess debt funding costs exceed 30% in which case a corresponding percentage can apply.

xix *Cyprus (Transfer Pricing)*. Circular No. 3, which was issued in 2017, introduced detailed transfer pricing rules concerning intragroup back-to-back financing arrangements.

xx *Cyprus (Patent Box)*. Cyprus has aligned its Patent Box regime with the B.E.P.S. Action Plan to reach full compliance with the "nexus approach." Benefits under the prior Cypriot Patent Box regime phase out by 2021.

xxi *France (C.I.T.)*. A 3.3% additional social contribution may apply on the portion of the C.I.T. that exceeds €763,000. A temporary exceptional contribution computed on the C.I.T. may apply (rates vary between 20.6% and 41.2% depending on the the turnover of the taxpayer).

xxii *Finland (C.I.T.).* The Finnish government has proposed that the corporate income tax rate will be lowered to 18% as of 2027.

xxiii *France (Dividends Paid)*. Most tax treaties entered into by France provide for a reduced rate of dividend withholding tax, generally ranging from 25% to 5%, and in some cases allow for zero withholding. The rate of withholding is 75% for payments made to persons resident in countries on France's list of noncooperative countries and territories.

xxiv *Finland (Dividends Paid).* Conditions and exceptions apply.

xxv *France (Dividends Received)*. The first rate corresponds to the application of the D.R.D. regime (95% exemption). This rate may vary if the 3.3% additional social contribution applies, as well as temporary exceptional contribution.

xxvi *France (Capital Gains)*. The first rate corresponds to the application of the C.G.T. regime (88% exemption). This rate may vary if the 3.3% additional social contribution applies, as well as temporary exceptional contribution.

xxvii *France (Double Tax Relief)*. Treaty relief generally includes exemptions or a foreign tax credit. Unilateral relief is available under the territoriality principle or a credit.

xxviii *Finland (Tax Treaties).* 73 treaties in force with 80 countries in total.

xxix *France (C.F.C. Rules)*. Trusts are among the targeted foreign structures.

xxx *France (Debt vs. Equity)*. The deductibility of interest expense is limited to the higher of 30% of adjusted tax E.B.I.T.D.A and €3 million. Thin capitalization applies if related debts exceeds 1.5 equity.

xxxi *France (Debt vs. Equity).* Several limitations are placed on interest expense deductions, including a specified cap that is 1.15% for Q1 2022, the *Charasse Amendment* on debt pushdowns, and A.T.A.D. (€3.0 million of net interest expense or 30% of E.B.I.T.D.A., if greater).

xxxii *Germany (C.I.T.)*. While the regular C.I.T. rate is 15%, the effective rate is approximately 30%. This rate is obtained by multiplying the regular corporate tax rate of 15% by a 5.5% solidarity surcharge and by adding a municipal trade tax that may vary from 7% to 17%.

xxxiii *Ireland (C.I.T. Rate).* Ireland has implemented an O.E.C.D Pillar Two-compliant Q.D.M.T.T. which imposes, on a jurisdictional basis, a top-up tax to bring the effective rate of in-scope entities to 15%.

xxxiv *Germany (Dividends Paid)*. The statutory rate of German withholding tax is 25% (plus a solidarity surcharge of 5.5%). Foreign corporations may claim a refund of two-fifths of the withholding tax (the effective withholding tax rate is 15% plus the solidarity surcharge). Germany has also enacted anti-treaty shopping and anti-directive-shopping rules regarding the use of intermediate holding companies. These anti-abuse rules may deny reduced withholding tax rates under certain circumstances.

xxxv *Ireland (Dividends Received).* Dividend distributions received from another Irish company are generally exempt. With respect to dividends received from foreign subsidiaries, Ireland operates a system of both treaty credit relief and unilateral credit relief, whereby credit for foreign tax is available against Irish tax on dividends received from certain foreign shareholdings. The tax rate on dividends received from a non-Irish corporation is either 12.5% (for dividends paid out of trading profits by certain companies) or 25%. Additionally, a participation exemption was introduced in respect of dividends received on or after January 1, 2025, by an Irish tax resident company from a company which is tax resident in an E.U. or E.E.A. Member State or in a country with which Ireland has concluded a tax treaty, provided certain conditions are satisfied. This participation exemption for foreign dividends is an optional regime and will only apply to taxpayers who elect into the new regime.

xxxvi *Germany (V.A.T.)*. A reduced rate of 7% applies in some areas. As a measure to help the economy in the COVID 19 crisis the V.A.T. rate was reduced to 16% respectively 5% from July 1, 2020 until December 31, 2020.

xxxvii *Germany (Capital Tax / Stamp Duty)*. No capital tax or stamp duty as such are levied. Registration fees may however apply.

xxxviii *Germany (Debt vs. Equity)*. No deduction applies for interest payments in excess of 30% of E.B.I.T.D.A. In Germany, this is also known as the “interest deduction ceiling.”

xxxix *Ireland (Debt vs. Equity).* An interest limitation rule (I.L.R.) was introduced under Finance Act 2021, taking effect for accounting periods commencing on or after January 1, 2022. The effect of the I.L.R. is to reduce the maximum tax deduction allowed for net borrowing costs to 30% of the taxpayer's E.B.I.T.D.A., though a number of exclusions exist in respect of legacy debt and where the interest group has net interest costs of less than €3 million.

xl *Ireland (Transfer Pricing)*. Irish transfer pricing legislation was revised in 2019 and is based on O.E.C.D. recommendations. This extends the legislation to bring certain domestic non-trading transactions and capital transactions within scope, as well as certain transactions involving S.M.E's.

xli *Germany (Patent Box)*. A license barrier rule applies to expenses arising from the year 2018 onward. The legislation restricts the deduction of royalties and similar payments made to related parties if, in the other country, the payments are (i) subject to a preferential tax regime (*i.e.,* patent box) that is not compliant with the O.E.C.D. nexus approach and (ii) effectively taxed at a rate below 15%.

xlii *Ireland (Patent Box)*. The Knowledge Development Box ("K.D.B.") was introduced in Ireland in 2015. Qualifying income is taxed at an effective reduced corporate tax rate of 10%. The K.D.B. is in line with the B.E.P.S. Action Plan.

xliii *Luxembourg (C.I.T.)*. This the rate applicable in Luxembourg City. The general corporate rate is 17%. A 7% surcharge applies, which results in an overall rate of 18.19%. Luxembourg City adds a 6.75% municipal business tax, which results in a 24.94% Luxembourg City rate.

xliv *Italy (P/E)*. Classified as financial fixed assets, 12 months holding period, the subsidiary must be resident in a country which is not considered as blacklisted and must be engaged in an active business

xlv *Italy (Dividends Paid)*. In order to qualify for the P.S.D. exemption, a minimum holding period of one year and a minimum shareholding of 10% is required. E.U. companies not covered by the P.S.D. are subject to a withholding rate of 1.20%.

xlvi *Luxembourg (Dividends Received)*. There is a 50% exemption for certain dividends not qualifying under the participation exemption which are then subject to tax under general corporate rates.

xlvii *Luxembourg (Capital Gains)*. Capital gains are taxable up to the amount of previously deductible expenses that are linked to the exempt participation. Such taxable amount can be offset against available losses (carried forward).

xlviii *Italy (Double Tax Relief)*. Excess credits may be carried back and carried forward over an eight-year period.

xlix *Luxembourg (Double Tax Relief)*. Treaties supersede domestic law, unless domestic law is more favorable.

l *Italy (Debt vs. Equity)*. The general limitation applies on the amount of the payment in excess of earned interest, if any. The excess amount is only deductible up to 30% of E.B.I.T.D.A., which must be quantified on the basis of the relevant tax values, *i.e.*, reflecting the corporate income tax adjustments applied to E.B.I.T.D.A. computed for accounting purposes.

li *Luxembourg (Debt vs. Equity)*. In practice, a ratio of 85:15 is applied to the financing of qualifying subsidiaries. No deduction applies for interest payments exceeding interest income in excess of 30% of E.B.I.T.D.A. or €3 million.

lii *Italy (Patent Box)*. A super-deduction of 110% of the cost incurred for R&D activities (development, enhancement, maintenance, protection and exploitation) is provided in relation to copyrighted software, patents, designs, and models. Trademarks and know-how are excluded from the list of eligible assets. The option must be made in the tax return relating to the tax year in which the Patent Box regime applies. Once elected, it is irrevocable for five years and renewable. The Patent Box regime is aligned with the B.E.P.S. Action Plan.

liii *Malta (P/E).* There is no minimum ownership requirement but under the savings clause 10% may be required if alternative tests are not met. There is no minimum holding period requirement but under the savings clause a holding period of 183 days in conjunction with a €1,164,000 investment may be required if alterative tests are not otherwise met.

liv *Netherlands (Dividends Paid)*. Under certain conditions, the dividend withholding tax may be reduced by 3% to compensate for foreign withholding taxes that cannot be claimed as a credit by the holding company by virtue of the participation exemption.

lv *Netherlands (Double Tax Relief)*. Tax treaties take priority over domestic law. Foreign taxes may be deductible as expenses if no other method applies.

lvi *Malta (V.A.T.)*. Reduced rates of 12%, 7% and 5% may apply.

lvii *Malta (Capital Tax)*. Maltese law does not prescribe any capital taxes upon incorporation, but does provide for a company registration fee, payable to the Malta Business Registry on the basis of the authorized share capital of the company. The fee ranges from a minimum of €100 to a maximum of €1,900 if the incorporation documents are submitted in electronic format. Higher fees apply if the incorporation documents are filed in paper format.

lviii *Netherlands (Debt vs. Equity)*. Interest paid on base erosion loans is not deductible, and as a consequence of the earnings stripping rule included in A.T.A.D.1, from 2022 onwards, interest deduction is limited to the greater of (i) 20% of the taxpayer's E.B.I.T.D.A. or (ii) €1 million.

lix *Malta (Patent Box)*. No determinations under the current Patent Box regime will be issued after June 30, 2016, and benefits will phase out by June 30, 2021.

lx *Netherlands (Patent Box)*. A 9% effective tax rate may apply to income generated by qualifying intangibles in line with the B.E.P.S. Action Plan.

lxi *Portugal (C.I.T.)*. A State surcharge may apply, with progressive tax rates: 3% (on income over €1.5 million), 5% (on over €7.5 M) or 9% (on over €35 million). A Municipal surcharge may also apply, with a legal maximum rate of 1.5%, but an exemption or lower rates may be available depending on the specific rules of each municipality.

lxii *Portugal (P/E)*. Dividends and capital gains derived by non-resident entities may also benefit from a C.I.T. exemption under certain conditions.

lxiii *Portugal (Dividends Paid)*. Under most tax treaties, withholding tax is reduced to 10% or 15%, with some treaties foreseeing the possibility of a rate of 5%.

lxiv *Spain (Dividends Paid)*. Dividends distributed out of qualified 95% exempt income (*i.e.*, dividends and capital gains that were exempt from tax at the level of the Spanish holding company) are not subject to withholding tax unless the recipient is resident in a country or territory that is considered a tax haven or noncooperative jurisdiction by Spain.

lxv *Portugal (Double Tax Relief)*. Portugal concedes unilateral double taxation relief by means of foreign tax credit. When a tax treaty is available with the relevant country, the foreign tax credit is limited to the amount of tax that is due under the relevant treaty.

lxvi *Spain (Double Tax Relief)*. Foreign tax credits on non-exempt foreign-source income may be credited against the 25% corporation income tax, limited to the Spanish corporation income tax payable on the foreign-source income. However, the application of foreign tax credits by taxpayers with an annual turnover exceeding €20 million will be limited to 50% of the tax due before the deduction of the foreign tax credit. Foreign tax credits not deducted may be carried forward and deducted in subsequent tax years.

lxvii *Spain (Tax Treaties)*. 24 countries are on Spain's noncooperative list.

lxviii *Portugal (Debt vs. Equity).* A.T.A.D. rule applies to net interest expense deduction (€1.0 million or 30% of E.B.I.T.D.A., if greater).

lxix *Spain (Debt vs. Equity)*. Several limitations are placed on interest expense deductions. Consistent with A.T.A.D., no deduction applies for net interest expense in excess of 30% of E.B.I.T.D.A. or €1.0 million if greater. Interest derived from intragroup profit participation loans are treated as return on equity.

lxx *Spain (Patent Box)*. Up to 60% of income derived from the use of a qualified intangible asset is reduced from corporation income tax, provided that several conditions are met. The patent box regime is aligned with the B.E.P.S. Action Plan.

lxxi *Switzerland (C.I.T.)*. The general federal corporate tax rate is 8.5%. Considering that this tax is deductible, the effective federal corporate rate is brought down to 7.8%. However, cantonal and communal taxes also apply.

lxxii *Switzerland (P/E)*. Corporate tax is reduced proportionally to dividend over total income.

lxxiii *Sweden (Dividends Paid)*. If the shares in the distributing company are deemed business-related shares under the participation exemption regime and the dividend (or capital gains at disposal of the shares) would have been tax exempt if the entity holding the shares had been a Swedish company, the dividend is exempt from withholding tax. Further, when the recipient of the dividend is a company in a E.U. member state that holds at least 10%t of the of the capital in the Swedish company and fulfills the terms in Article two of the Directive 2011/96/EU, Parent Subsidiary Directive, the dividend is exempt from withholding tax. Exemption also applies to foreign contractual funds. In addition, certain funds within the E.E.A. and within countries with which Sweden has in force an income tax treaty or a treaty for exchange of information relating to tax matters are exempt from withholding tax.

lxxiv *Switzerland (Dividends Paid)*. In many cases, a full or partial refund of Swiss withholding tax is available by following notification procedures. The Swiss tax authorities must be notified in advance of the distribution and grant permission for relief. Under the Swiss-E.U. Savings Tax

Agreement, dividends paid to any E.U. parent company may follow the notification procedures and receive a full refund of withholding tax if the parent controls at least 10% of the Swiss subsidiary (or a lesser percentage, as provided by an applicable tax treaty). For shareholders resident in other countries, dividend distributions may be subject to reduced Swiss withholding tax. The notification procedures should be available if the requirements of the relevant double tax treaty are met and permission for partial relief at the source has been obtained prior to distribution.

lxxv *Switzerland (C.I.T.)*. The general federal corporate tax rate is 8.5%. Considering that this tax is deductible, the effective federal corporate rate is brought down to roughly 7.8%. However, cantonal and communal taxes also apply.

lxxvi *Switzerland (C.I.T.)*. The general federal corporate tax rate is 8.5%. Considering that this tax is deductible, the effective federal corporate rate is brought down to roughly 7.8%. However, cantonal and communal taxes also apply.

lxxvii *Sweden (V.A.T.)*. A lower V.A.T. rate may apply depending on the type of goods or service.

lxxviii *Switzerland (V.A.T.)*. A Swiss holding company may be subject to V.A.T. at the standard rate if it provides services and receives management fees from affiliates or other service income in excess of CHF 100,000 per year. V.A.T. may be recovered by the payer if it is a supplier of taxable goods and services. In addition, the holding company may be entitled to recover V.A.T. on payments made to others, such as consultants and auditors.

lxxix *Sweden (Stamp Duty)*. Stamp duty applies only to real estate.

lxxx *Sweden (Debt vs. Equity)*. There is a general limitation of interest deductibility (net interest) to 30 % of E.B.I.T.D.A. There is also an intercompany interest deduction limitation based on commercial justification for borrowing.

lxxxi *Switzerland (Patent Box)*. Regime in place in some cantons. All Swiss cantons introduced a patent box regime with a

90% exclusion allowed for qualifying income. The new regime is in line with the B.E.P.S. Action Plan.

lxxxii *United Kingdom (P/E)*. Known as the "Substantial Shareholding Exemption."

lxxxiii *United Kingdom (Dividends Paid)*. The U.K. does not impose withholding tax on dividends to nonresident shareholders as a matter of domestic law. The U.K. does not impose withholding tax on dividends to nonresident shareholders as a matter of domestic law. However, U.K. withholding tax at 20% applies to property income distributions ("P.I.D.'s") paid in relation to certain qualifying activities by R.E.I.T.'s to shareholders who are not within the charge to corporation tax (which can include companies not resident in the U.K). This may be reduced by an applicable U.K. income tax treaty. Since a company will not be able to qualify as a R.E.I.T. if it has corporate shareholders with a 10% or greater participation, treaty relief will be at the rate applicable to portfolio dividends. This rate currently is 15% for qualified U.S. residents under the U.K.-U.S. Income Tax Treaty. The position is essentially the same with respect to the 20% withholding that applies to P.I.D.'s made by property-authorized investment funds.

lxxxiv *United Kingdom (Dividends Received)*. In principle, dividends received by U.K. holding companies are subject to tax unless specifically exempt. However, the exemptions available are broad, and in practice most distributions received will fall under one of them.

lxxxv *United Kingdom (Capital Gains)*. Note that significant changes have recently been introduced in relation to the taxation of gains realized on disposals of U.K. real estate by non-UK resident companies.

lxxxvi *United Kingdom (Debt vs. Equity)*. The thin capitalization rules are part of the U.K.'s transfer pricing legislation. No deduction applies for net interest expense in excess of 30% of E.B.I.T.D.A.

lxxxvii *United Kingdom (Patent Box)*. The prior Patent Box regime is being phased out. As of July 1, 2016, a new Patent Box became available that is aligned with the B.E.P.S. Action Plan.

2. INTRODUCTION[1]

A. Global Tax Planning in a Pre-2018 World[2]

Prior to 2018, widely-used tax plans of U.S.-based multinational groups were designed to achieve three basic goals in connection with European operations: (i) the reduction of European taxes as European profits were generated, (ii) the integration of European tax plans with U.S. tax concepts to prevent Subpart F from applying to intercompany transactions in Europe, and (iii) the reduction of withholding taxes and U.S. tax under Subpart F as profits were distributed through a chain of European companies and then to the global parent in the U.S.

i. Reduction of Taxes in Europe

The first goal – the reduction of European taxation on operating profits – often entailed the deconstruction of a business into various affiliated companies, which can be illustrated as follows:

- Group equity for European operations was placed in a holding company that served as an *entrepôt* to Europe.

---

1 This chapter of the article was written by Stanley C. Ruchelman of Ruchelman P.L.L.C., New York. The author acknowledges the contributions of Michael Bennett and Wooyoung Lee regarding certain events in the U.S. during 2024.

2 All of the authors acknowledge the contribution of Francesca York, an alumna of Ruchelman P.L.L.C., for converting 20 separate submissions prepared by persons having a multitude of birth languages into a cohesive and accurate monograph.

- Tangible operating assets related to manufacturing or sales were owned by a second company or companies where the facilities or markets were located.

- Financing was provided by a third company where rulings or legislation were favorable.

- Intangible property was owned by a fourth company qualifying as an innovation box company.

If the roadmap was carefully followed, European taxes on operations could be driven down in ways that did not result in immediate U.S. taxation under Subpart F. A simplified version of the plan that was widely used by U.S.-based multinational groups involved the following steps:

- Form an Irish controlled foreign corporation ("TOPCO") that is managed and controlled in Bermuda

- Have TOPCO enter into a qualified cost sharing agreement with its U.S. parent providing for the emigration of intangible property to TOPCO for exploitation outside the U.S. at an acceptable buy-in payment that could be paid overtime

- Have TOPCO form a Dutch subsidiary ("DCO") to serve as a licensing company, and an Irish subsidiary ("OPCO") to carry on active business operations

- Make check-the-box elections for DCO and OPCO so that both are treated as branches of TOPCO

Have TOPCO license the rights previously obtained under the qualified cost sharing agreement to DCO and have DCO enter a comparable license agreement with OPCO.

The use of check-the-box entities within Europe eliminated Subpart F income from being recognized in the U.S. A functionally comparable arrangement could be obtained for intercompany loans where such loans were required for capital investments. The qualified cost sharing arrangement eliminated the application of

Code §367, which otherwise would mandate ongoing income inclusions for the U.S. parent as if it sold the intangible property pursuant to a deferred payment arrangement with the sales price being contingent on future revenue. Any intercompany dividends paid within the group headed by TOPCO were ignored for Subpart F purposes because of the check-the-box elections made by all of TOPCO's subsidiaries. At the same time, deferred taxes were not reported as current period expenses on financial statements prepared by the U.S. parent provided the underlying earnings were permanently invested abroad.

Meanwhile, earnings were funneled up to the European group equity holder and recycled for further expansion within the European group. Intragroup payments typically did not attract withholding tax under the Parent-Subsidiary Directive ("P.S.D.") or the Interest and Royalty Directive ("I.R.D.") of the European Commission ("E.C.").

For other U.S.-based groups – primarily, those companies that regularly received dividend payments from European operations – the use of a holding company could reduce foreign withholding taxes claimed as foreign tax credits by the U.S. parent in many instances. This was true especially where the U.S. did not have an income tax treaty in force with a particular country or the treaty provided for relatively high withholding tax rates on dividends. Nonetheless, sophisticated planning was often required to take full advantage of the foreign tax credit because of various limitations and roadblocks that existed under U.S. tax law.

ii. <u>Foreign Tax Credit Planning in the U.S.</u>

Although the foreign tax credit has often been described as a "dollar-for-dollar reduction of U.S. tax" when foreign taxes are paid or deemed to be paid by a U.S. parent company, the reality has been quite different. Only taxes that were imposed on items of "foreign-source taxable income" could be claimed as credits.[3] This rule, known as "the foreign tax credit limitation," was intended to prevent foreign income taxes from being claimed as a credit against U.S. tax

---

[3] Section 904(a) of the Internal Revenue Code of 1986, as amended from time to time ("Code").

on U.S.-taxable income. The U.S., as with most countries that eliminate double taxation through a credit system, maintains that it has primary tax jurisdiction over domestic taxable income.

The foreign tax credit limitation was structured to prevent so-called "cross crediting," under which high taxes on operating income could be used to offset U.S. tax on lightly taxed investment income. For many years, the foreign tax credit limitation was applied separately with regard to eight different categories, or baskets, of income designed to prevent the absorption of excess foreign tax credits by low-tax foreign-source income. In substance, this eviscerated the benefit of the foreign tax credit when looked at on an overall basis. The problem was eased when the number of foreign tax credit baskets was reduced from eight to two: passive and general.

Additionally, the foreign tax credit was reduced for dividends received by U.S. citizens and resident individuals from foreign corporations that, in the hands of the recipient, benefited from reduced rates of tax in the U.S. A portion of foreign dividends received by U.S. individuals that qualify for the 0%, 15%, or 20% tax rate under Code §1(h)(11)(B)(i) was removed from the numerator and denominator of the foreign tax credit limitation to reflect the reduced U.S. tax rate imposed on those items.[4] This treatment reduced the foreign tax credit limitation when a U.S. citizen or resident individual received both qualifying dividends from a foreign corporation – subject to low tax in the U.S. – and other items of foreign-source income within the same basket – subject to much higher ordinary tax rates. Another reduction in foreign source gains applied when U.S. source losses reduced foreign source gains. The goal of the provision was to eliminate a double benefit for the taxpayer regarding foreign source gains in that fact pattern. The first benefit was use of a domestic loss to reduce the foreign gain when computing taxable income. The second benefit was the elimination of U.S. tax due by reason of the foreign tax credit.[5]

---

4 Code §§1(h)(11)(C)(iv) and 904(b)(2)(B).

5 Code §904(b)(2)(A).

As a result of all the foregoing rules, a U.S.-based group was required to determine (i) the portion of its overall taxable income that was derived from foreign sources, (ii) the portion derived in each "foreign tax credit basket," and (iii) the portion derived from sources in the U.S. This was not an easy task, and in some respects, the rules did not achieve an equitable result from management's viewpoint.

iii. Allocation and Apportionment Rules for Expenses

U.S. income tax regulations required expenses of the U.S. parent company to be allocated and apportioned to all income, including foreign dividend income.[6] The allocation and apportionment procedures set forth in the regulations were exhaustive and tended to maximize the apportionment of expenses to foreign-source income. For example, all interest expense of the U.S. parent corporation and the U.S. members of its affiliated group were allocated and apportioned under a set of rules that allocated interest expense on an asset-based basis to all income of the group.[7] Direct tracing of interest expense to income derived from a particular asset was permitted in only limited circumstances[8] involving qualified nonrecourse indebtedness,[9] certain integrated financial transactions,[10] and certain related controlled foreign corporation ("C.F.C.") indebtedness.[11] Research and development expenses, stewardship expenses, charitable deductions, and state franchise taxes needed to be allocated and apportioned among the various classes of income reported on a tax return. These rules tended to reduce the amount of foreign-source taxable income in a particular

---

6 Treas. Reg. §§1.861-8 through 17.

7 Treas. Reg. §§1.861-9T(f)(1) and (g).

8 Treas. Reg. §1.861-10T(a).

9 Treas. Reg. §1.861-10T(b).

10 Treas. Reg. §1.861-10T(c).

11 Treas. Reg. §1.861-10T(e).

category, and in some cases, eliminated all income in that category altogether.

The problem was worsened by carryovers of overall foreign loss accounts.[12] These were "off-book" accounts that arose when expenses incurred in a particular prior year that were allocable and apportionable to foreign-source income exceeded the amount of foreign-source gross income for the year. Where that occurred, the loss was carried over to future years and reduced the foreign-source taxable income of the subsequent year when computing the foreign tax credit limitation.

iv. Self-Help Through Inversion Transactions

The pressure that was placed on the full use of the foreign tax credit by U.S.-based groups resulted in several public companies undergoing inversion transactions. In these transactions, shares of the U.S. parent company held by the public were exchanged for comparable shares of a newly formed offshore company to which foreign subsidiaries were eventually transferred. While the share exchange and the transfer of assets arguably were taxable events, the identity of the shareholder group (*i.e.*, foreign persons or pension plans) or the market value of the shares (*i.e.*, shares trading at relatively low values) often eliminated actual tax exposure in the U.S. Thereafter, the foreign subsidiaries were owned directly or indirectly by a foreign parent corporation organized in a tax-favored jurisdiction and the foreign tax credit problems disappeared.

This form of "self-help" was attacked in the anti-inversion rules of Code §7874. In some circumstances, Code §7874 imposes tax on inversion gains that cannot be reduced by credits or net operating loss carryforwards.[13] This occurs in the case described below:

- A foreign corporation acquires substantially all of the properties held directly or indirectly by a domestic

---

[12] Code §904(f).

[13] Code §7874(a)(1).

corporation or substantially all of the properties constituting a trade or business of a domestic partnership.

- After the acquisition, at least 60% of the stock of the acquiring entity is held by either (i) former shareholders of the domestic corporation by reason of their holding stock in the domestic corporation or (ii) former partners of the domestic partnership by reason of holding a capital or profits interest in the domestic partnership.

- After the acquisition, the expanded affiliated group which includes the entity does not have substantial business activities in the foreign country in which, or under the law of which, the entity was created or organized when compared to the total business activities of the expanded affiliated group.[14]

In other circumstances, the acquiring entity is considered to be a domestic corporation for purposes of U.S. tax law. This occurs when the former shareholders or partners own at least 80% of the stock of the acquiring entity after the transaction.[15]

Broad regulatory authority has been granted to the I.R.S. to carry out the purposes of Code §7874. By 2017, 12 regulations were issued to address situations that appear to be beyond a literal reading of the statute, but are nonetheless deemed to be abusive by the I.R.S. Abuses that have been addressed by the I.R.S. include the following examples:

- Identifying circumstances where the minimum stock ownership requirement ostensibly is not met, but the foreign acquiring corporation holds a significant amount of passive assets, suggesting the existence of an asset-stuffing

[14] Code §7874(a)(2)(B).

[15] Code §7878(b).

transaction intended to avoid a trigger for application of the anti-inversion provisions.[16]

- Combining prior acquisitions of U.S. targets by the foreign acquirer when used to bolster a much larger single acquisition of a target.[17]

- Combining prior acquisitions of foreign targets by the foreign acquirer when used to bolster a much larger single acquisition of a target.[18]

- Addressing certain transfers of stock of a foreign acquiring corporation, through a spin-off or otherwise, following an acquisition.

- Identifying the occurrence of certain distributions that are not made in the ordinary course of businesses by the U.S. entity, suggesting an intent to avoid a trigger for application of the anti-inversion provisions.[19]

- Identifying the acquisition by a C.F.C. of obligations of or equity investments in the new foreign parent corporation or certain foreign affiliates suggesting an intent to avoid taxable investments in U.S. property when such investments were taxable in the hands of a U.S. parent corporation.[20]

---

16 Treas. Reg. §1.7874-7.

17 Treas. Reg. §1.7874-8.

18 Treas. Reg. §1.7874-9.

19 Treas. Reg. §1.7874-10.

20 Treas. Reg. §1.7874-11. The adoption of Code §245A eliminates the taxable event that otherwise exists for an investment in U.S. property in the context of a U.S. corporation owning 10% or more of the shares of a foreign corporation. See Treas. Reg. §1.956-1(a)(2).

- Addressing the investment of pre-inversion earnings and profits of a C.F.C. through a post-inversion transaction that terminates the C.F.C. status of foreign subsidiaries or substantially dilutes a U.S. shareholder's interest in those earnings and profits.[21]

- Related-party stock sales subject to Code §304 (which converts a stock sale of controlled stock into a dividend payment) that are intended to remove untaxed foreign earnings and profits of a C.F.C.[22]

In 2016, the Treasury Department adopted updates to the U.S. Model Income Tax Convention (the "2016 U.S. Model"), which serves as the basic document that the U.S. submits when negotiating an income tax treaty. The draft provisions propose, *inter alia*, to reduce the tax benefits that may be enjoyed by an expatriated group by imposing full withholding taxes on key payments such as dividends,[23] interest,[24] and royalties[25] made to connected persons that are residents of a treaty country by "expatriated entities" as defined under the Code. This treatment lasts for ten years and goes to the heart of the bargain between the U.S. and its treaty partners where the full U.S. withholding tax reduces the tax in the country of the recipient or the dividend is not taxable in the treaty partner country under a participation exemption.

B. Global Tax Planning in a Post-2017 World

The year 2017 sounded the death knell for cross-border tax planning carried on in the old-fashioned way.

---

21 Treas. Reg. §1.7874-12.

22 Treas. Reg. §1.304-7T.

23 Paragraph 5 of Article 10 (Dividends) of the 2016 U.S. Model.

24 *Id.,* ¶2(d) of Article 11 (Interest).

25 *Id.,* ¶2 of Article 12 (Royalties).

By the end of 2017, too many barriers were in place to continue on with established planning strategies. First in line were the actions taken by the Organization for Economic Cooperation and Development ("O.E.C.D.") to curtail base erosion and profit shifting through adoption of the B.E.P.S. Project. Second, a never-ending package of directives issued by the European Commission and proposals by the European Parliament were designed to attack various tax plans in various ways, including all of the following measures:

- The Anti-Tax Abuse Directives ("A.T.A.D. 1," "A.T.A.D. 2," and most recently A.T.A.D. 3")
- The disclosure and dissemination of tax rulings
- The institution of ownership registers that will disclose the ultimate beneficial ownership of entities
- The mandatory reporting of aggressive tax planning under Council Directive (E.U.) 2018/822 amending Directive 2011/16/E.U. ("D.A.C. 6")
- Limitations placed on the P.S.D. and the I.R.D. to block their application within a European group owned by a non-European parent company

At the same time, tax plans that were previously approved by tax administrations were characterized as a form of unlawful State Aid, triggering severe repayment obligations from benefiting companies.

i. European Attacks on Cross-Border Holding Companies and Tax Planning

Attacks on tax planning for cross-border holding companies have taken three approaches. The first is based on economic substance. The second is based on E.C. Directives. The third is based on transposition of the B.E.P.S. Actions into national law throughout Europe.

a. <u>Attacks Based on Economic Substance</u>

Tax benefits claimed by holding companies in Europe are now regularly challenged by the tax authorities of European countries in which companies making payment are resident. The challenges are directed at the substance of the holding company. Questions frequently asked include whether the holding company has payroll costs, occupancy costs, and local management involved in day-to-day decision-making.[26] In some instances, the capital structure of the holding company is queried. Most recently, the European Commission published a proposal for a Directive laying down rules to prevent the misuse of shell entities for improper tax purposes.[27]

For a U.S.-based group that has little tolerance to tax risk, these challenges suggest that it is prudent for a holding company to have more than just tax residence in a particular country – it should conduct group functions in that country and be ready to provide evidence of the activities performed. These challenges within Europe should be compared with the approach to substance that is found in the limitation on benefits articles of U.S. income tax treaties. Objective standards are typically provided under which substance is judged to exist. In addition, ongoing business activities of a group member can be attributed to related parties. In particular, the active trade or business provision of most limitation on benefits articles allows intermediary holding companies to be viewed as active participants in a business if they own at least 50% of a

---

26 A series of cases decided by the Court of Justice of the European Union ("C.J.E.U.") reflect the approach of the U.S. Tax Court in *Aiken Industries, Inc. v. Commr.,* 56 T.C. 925 (1971), and the I.R.S. in Rev. Rul 84-152 and Rev. Rul. 84-153 and ultimately Treas. Reg. §1.881-3. See *N Luxembourg 1 v. Skatteministeriet*, Joined Cases C-115, C-118, C-119 & C-299/16, [2019] ECLI:EU:C:2019:134; *Skatteministeriet v. T Danmark und Y Denmark Aps*, Joined Cases C-116/16 & C-117/16, [2019] ECLI:EU:C:2019:135.

27 The Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/E.U. The proposal was issued on December 22, 2021.

subsidiary or partnership that has active business operations. These provisions eliminate intra-European challenges of tax authorities and may incentivize direct investment.

b. Attacks Based on the B.E.P.S. Action Plan

Substance is also a key concern in the Final B.E.P.S. Package for Reform of the International Tax System to Tackle Tax Avoidance published by the O.E.C.D. The reports were commissioned by the G-20 and reflect findings that a disparity often exists between (i) the location of actual business activities and investment and (ii) the jurisdiction where the resulting profits are reported for tax purposes.

The reports set out how current cross-border taxation rules may create B.E.P.S. opportunities, thereby resulting in a reduction of the share of profits associated with substantive operations. They also emphasize how changes in global business practices are ahead of current international tax standards, with a special focus on intangibles and the digital economy. The reports identify (i) a need for increased transparency on the effective tax rates of multinational enterprises and (ii) the existence of key pressure areas as far as B.E.P.S. is concerned. These include the following key areas:

- International mismatches in entity and instrument characterization
- The application of treaty concepts to profits derived from the delivery of digital goods and services
- The tax treatment of related party debt-financing
- Captive insurance and other intragroup financial transactions
- Certain aspects of generally recognized transfer pricing rules
- The effectiveness of anti-avoidance measures
- The availability of harmful preferential regimes

The reports adopt a set of comprehensive, global, internationally coordinated action plans to effectively address the identified problem areas. The O.E.C.D. governments are particularly committed to the development of proposals to implement this action plan. Many U.S.-based multinational groups fear that the proposals will overturn arm's length principles that have been recognized internationally for many years. Their fears have been justified.

In 2021, the O.E.C.D. proposed Pillar One and Pillar Two. According to the O.E.C.D., Pillar One reallocates the profits of about 100 of the world's largest and most profitable multinational enterprises to market jurisdictions. For a targeted company, Pillar One expands the taxing rights of market jurisdictions to collect tax from the targeted enterprise, regardless of physical presence. Not covered by Pillar One are companies in the extractives sector, such as oil, gas, and mining companies. Also excluded are regulated companies operating in the financial services sector.

Pillar Two is designed to ensure that a multinational enterprise pays a minimum level of tax, regardless of the location of its headquarters or the jurisdictions in which it operates. Pillar Two is thought to target approximately 2,000 multinational corporations and is expected to raise about $150 billion in additional global tax revenue annually. Consequently, those persons who invest directly or indirectly in companies that are targeted will be adversely affected. Pillar Two establishes a global minimum effective tax rate of 15%. It applies to multinational groups with consolidated group revenue of at least €750 million. Countries may elect to adopt a lower threshold for application. Under the Pillar Two income inclusion rule ("I.I.R."), a "top-up" tax to the 15% global minimum rate is imposed on the parent of the group by its country of residence if a member tries to shift profits to low-tax or no-tax jurisdictions. If the tax is not collected by the ultimate parent in a chain of ownership, the jurisdiction of residence of the next lower company in the chain may impose the tax, and so on until the I.I.R. amount is fully collected. Pillar Two also includes an under-taxed payments rule ("U.T.P.R."), under which a deduction for undertaxed cross-border payments is disallowed for the company making the payment. Alternatively, that country may impose a withholding tax on the payment. Note that a payment to a company that triggers the application of the I.I.R. for its ultimate parent does not prevent the

U.T.P.R. rule from applying in the jurisdiction of the company making the payment.

While the B.E.P.S. Reports have no legal authority, they reflect a political consensus in Europe and elsewhere regarding steps to be taken to shut down transactions that are perceived to be abusive. Consequently, the B.E.P.S. Reports must be considered before setting up a foreign holding company in Europe. To illustrate, the Council of Economic and Finance Ministers ("Ecofin") has recommended changes in the P.S.D. designed to eliminate the exemption enjoyed by parent companies for dividends paid by subsidiaries when the subsidiary claims a deduction for the payment. E.U. Member States implemented the change to the P.S.D. in 2016.[28]

The B.E.P.S. Reports reflect a view that is now accepted by tax authorities throughout Europe. Taxation should not be viewed as an expense. Rather, it reflects a profit-sharing arrangement between governments and businesses, akin to the interest of limited partners in a limited partnership. The multinational enterprise is looked at as if it is the general partner and governments are looked at as limited partners. Viewed in this light, schemes with no substance cannot be allowed to deprive the governments of their "profit share." Such a scheme does not reflect good tax planning; rather, it is viewed as theft, plain and simple. In what is known as the Cum-Ex scandal,[29] Denmark is actively pursuing civil claims against facilitators of a specific tax refund arrangement that took advantage of flawed withholding tax rules for dividend payments by Danish companies. The defendants are individuals, professional firms, and advisers,

---

[28] See also the Danish Cases discussed at note 24, where the C.J.E.U. adopted B.E.P.S. concepts as part of European Law.

[29] See Sunita Doobay and Stanley C. Ruchelman, *Adventures in Cross-Border Tax Collection: Revenue Rule vs. Cum-Ex Litigation*, Tax Notes International, April 18, 2022, cover and pp. 329-372 and Tax Notes Federal, April 18, 2022, pp. 359- 403.

based mostly in the U.S. and the U.K. It is reported that Denmark has budgeted $380 million for legal costs to purse its targets.

c. **Attacks Based on State Aid**

Cross-border tax planning within the E.U. has faced challenges based on concepts of State Aid, transparency, and the Common Reporting Standard. Until recently, tax planning was not viewed to be an item of unfair State Aid violating basic rules of the E.U. That has changed. In its place is a mechanism calling for information reporting designed to promote pan-European information exchange, both as to bank balances and "sweetheart" tax rulings.

Following the O.E.C.D. B.E.P.S. Reports, the European Commission introduced an anti-tax avoidance directive (*i.e.*, the A.T.A.D. 1). It was adopted on June 20, 2016, and contains anti-tax avoidance rules in five specific fields:

- Exit taxation
- Interest deduction limitation
- C.F.C. rules
- The general anti-abuse rule ("G.A.A.R.")
- Hybrid mismatches

The rules are in addition to the changes to the P.S.D. (regarding G.A.A.R. and anti-hybrid financing rules) and may be followed by a relaunched proposal on the Common Corporate Tax Base ("C.C.T.B.") and the Common Consolidated Corporate Tax Base ("C.C.C.T.B.").

On February 21, 2017, the E.U. Member States agreed on an amendment to the A.T.A.D. 1 (*i.e.*, the A.T.A.D. 2), which provides detailed rules targeting various hybrid mismatches between Member States and countries outside the E.U. The following mismatches are included:

- Hybrid financial instrument mismatches

- Hybrid entity mismatches
- Reverse hybrid mismatches
- Hybrid transfers
- Hybrid permanent establishment mismatches
- Dual resident mismatches

ii. Revisions to U.S. Tax Rules Affecting Global Business

If these were not sufficient impediments to old-fashioned tax plans, the United States enacted the Tax Cuts & Jobs Act ("T.C.J.A.")[30] in late December 2017. Among other things, the T.C.J.A. revised U.S. law as follows:

- The corporate tax rates were reduced to 21%.
- The scope of the C.F.C. rules were expanded.
- The deemed paid foreign tax credit rules in connection with direct investment dividends received by corporations were replaced by an intercompany dividend received deduction ("D.R.D.") applicable to dividends received from 10%-owned foreign subsidiaries.
- Deductions are allowed for the use of foreign-derived intangible income generated by U.S. businesses from operations in the U.S. that service foreign markets.
- Deferral of earnings of a C.F.C. that are derived from the use of intangible property is eliminated.

---

30 *An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018*, Public Law 115-97, *U.S. Statutes at Large* 131 (2017): 2054-2238.

- Nonrecognition treatment for transfers of business assets to a foreign subsidiary has been eliminated.

- The transfer pricing statute (Code §482) has been amended to increase the income that is deemed to be realized from a transfer of ownership or use of intangible property to a foreign corporation.

- The opportunity to use of hybrid payments of interest and royalties to reduce Subpart F income of C.F.C.'s and taxable income foreign-controlled U.S. companies has been eliminated.

- A Base Erosion and Anti-Abuse Tax ("B.E.A.T.") has been imposed on large U.S. companies and U.S. branches of foreign companies in connection in order to reduce the tax benefit arising from deductible payments to foreign related parties.

a. Broadened Scope of Subpart F

Subpart F of the Code is applicable to C.F.C.'s and their "U.S. Shareholders," as defined below. It is a principal anti-deferral regime with relevance to a U.S.-based multinational corporate group. A C.F.C. generally is defined as any foreign corporation in which "U.S. Shareholders" own (directly, indirectly, or constructively) shares representing more than 50% of the corporation's voting power or value.

Certain rules of attribution apply to treat shares owned by one person as if owned by another. Shares may be attributed between individuals, corporations, partnerships, trusts, and estates. Consequently, the ownership of a taxpayer's shares in one company could be attributed to another company owned by the same taxpayer for the purposes of determining, *inter alia*, whether the second company is a U.S. Shareholder of a C.F.C. and whether two companies are related because one controls the other or both are under common control. Although ownership of shares is attributed from one person to another for the foregoing purposes, that attribution does not cause the latter person to be taxed under Subpart

F on the income of the C.F.C. In other words, income follows legal ownership.

Under prior law, a "U.S. Shareholder" was a U.S. person that owned shares of the foreign corporation having 10% or more of the voting power of all shares issued by the corporation. For this purpose, U.S. persons include U.S. citizens, U.S. residents, U.S. corporations, U.S. domestic trusts or estates, and U.S. partnerships and L.L.C.'s. In applying the attribution rules, shares could not be attributed from a foreign corporation to a U.S. corporation in which shares representing more than 50% of the voting power or value were owned in the U.S. corporation. In addition, before Subpart F could apply to a C.F.C. and its U.S. Shareholders, a foreign corporation was required to be a C.F.C. for at least 30 days during the taxable year.

The T.C.J.A. made several changes to the provisions of Subpart F. First, the definition of a U.S. Shareholder was expanded so that a person is a U.S. Shareholder of a foreign corporation if shares are owned in the foreign corporation and those shares represent at least 10% of the voting power *or the value* of the foreign corporation.

Second, if more than 50% of the shares in a U.S. subsidiary are owned by a foreign parent, the U.S. subsidiary constructively owns shares in all non-U.S. corporations that are actually owned by the foreign parent for the purposes discussed above. As a result, foreign-based groups with members in many countries, including the U.S., may find that all members based outside the U.S. are at risk of becoming C.F.C.'s for certain U.S. tax purposes, with the U.S. affiliate treated as if it were the parent company of the group. This can broaden the scope of information reporting, but not the imposition of tax within the group. However, it can affect unrelated U.S. persons owning 10% or more of the shares of a foreign corporation, causing such U.S. persons to pay tax immediately on its share of any Subpart F income of the newly categorized C.F.C. In essence, this rule attacks certain joint ventures abroad consisting of U.S. businesses and members of a foreign multinational group with subsidiaries in the U.S.

In 2018, the I.R.S. announced that it would not impose a reporting obligation on the U.S. entity in these circumstances, provided that no U.S. entity owns stock in such C.F.C., either directly or indirectly through a foreign subsidiary, and the foreign corporation is a C.F.C. solely because a U.S. entity constructively owns stock in the corporation through a foreign parent. This rule helped foreign based groups having members in the U.S. but not when U.S. persons co-invest directly or indirectly in a foreign joint venture company.

Finally, a foreign corporation is no longer required to be a C.F.C. for 30 days in order for Subpart F to apply to its U.S. Shareholders. This provision affects many tax plans put in place for high net worth individuals with children who live in the U.S. Those plans typically involved the use of foreign blocker corporations that protected U.S. situs investment assets from the imposition of U.S. estate taxes for a non-U.S. parent. At the same time, the plans allowed the children to have a tax-free step-up in cost basis in the investment assets if the foreign blocker is liquidated promptly after the parent's death.

b. **Cross-Border Intercompany Dividends Received Deduction**

Generally, U.S. citizens, residents, and domestic corporations are considered to be U.S. persons subject to tax on worldwide income. To eliminate double taxation of income, the U.S. allows a credit for foreign income taxes paid on foreign-source income. For taxpayers that are corporations, an indirect credit was allowed under prior law for foreign income taxes paid by foreign corporations when the U.S. corporation owned shares in a foreign corporation representing 10% or more of the voting power. Under the indirect foreign tax credit computations, a U.S. Shareholder of a C.F.C. kept track of the pool of the post-1986 earnings of the C.F.C. and the pool of foreign income taxes associated with those earnings. Foreign income taxes associated with post-1986 earnings were deemed paid on a proportional basis as the earnings in that pool were distributed. The indirect foreign tax credit reached down to the sixth level of foreign subsidiary, so long as the U.S. corporation indirectly owned at least 5% of the lower tier subsidiaries.

The T.C.J.A. abandons the indirect foreign tax credit and moves to a D.R.D. system.[31] A 100% deduction is allowed for the foreign-source portion of dividends received from 10%-owned foreign corporations. To be entitled to the D.R.D., a U.S. corporation must hold its 10% interest for more than 365 days in the 731-day period beginning on the date that is 365 days before the ex-dividend date in the declaration.

The D.R.D. is not available for hybrid dividends. These are amounts for which a deduction would be allowed under the D.R.D. rules except that the specified 10%-owned foreign corporation has already received a deduction or other tax benefit in any foreign country. Also, if a C.F.C. with respect to which a domestic corporation is a U.S. Shareholder receives a hybrid dividend from a related C.F.C., the hybrid dividend is treated as Subpart F income of the recipient C.F.C.[32] None of the exceptions to taxation under Subpart F are applicable.

The indirect foreign tax credit remains in effect to eliminate double taxation for U.S. corporations that are taxed under Subpart F in connection with foreign subsidiaries that are C.F.C.'s. However, the indirect foreign tax credit is not applicable to a hybrid dividend that gives rise to an income inclusion for a U.S. corporation that is a U.S. Shareholder.[33]

There is no equivalent to the D.R.D. for repatriations from a foreign branch. Income from foreign branches is taxed immediately and the taxpayer may claim a direct foreign tax credit for foreign income taxes paid. Foreign branch income is placed in a separate foreign tax credit limitation basket.[34]

---

31 Code §245A.

32 Code §245A(e)(2).

33 Code §245A(e)(3).

34 Code §904(d)(1)(B).

c. **<u>One-Time Transition Tax Accompanies Transition to D.R.D.</u>**

In order to create a level playing field for all earnings accumulated abroad in C.F.C.'s and other non-U.S. corporations in which a U.S. corporation owns sufficient shares to claim an indirect foreign tax credit, all post-1986 earnings of such foreign corporations are deemed to be distributed on the last day of the taxable year beginning prior to January 1, 2018.[35]

If the foreign corporation is a C.F.C., all U.S. Shareholders as defined under prior law report the income. If the foreign corporation is not a C.F.C., only 10% shareholders report the income, provided that at least one such shareholder is a U.S corporation.[36]

The rate of U.S. tax on the amount included in income is reduced by means of a notional deduction.[37] For U.S. corporations, the rate is 15.5% to the extent that the earnings have been invested in cash or cash equivalents, based on the balance sheet of the C.F.C. The balance of the earnings is taxed at a rate of 8%. The rate for individuals is assumed to be marginally higher.

Corporations may claim an indirect foreign tax credit for foreign income taxes paid by the C.F.C. in connection with the post-1986 pool of earnings. However, the pool of foreign income taxes is reduced to reflect the reduction in the tax rate of the U.S. Shareholder.[38]

At the election of the taxpayer, the total tax is computed on the tax return for 2017, but the taxpayer can also elect to pay the tax in eight annual installments, so that 40% of the total tax is paid in equal

---

35 Code §965.

36 Code §965(e).

37 Code §965(c).

38 Code §965(g).

installments over the first five years and the balance is paid in escalating installments over the last three years.[39]

For individual taxpayers who missed the April 18, 2018, deadline for making the first of the eight annual installment payments, the I.R.S. will waive the late-payment penalty if the installment is paid in full by April 15, 2019.[40] Absent this relief, a taxpayer's remaining installments over the eight-year period would have become due immediately. This relief is only available if the individual's total transition tax liability is less than $1 million.

The validity of the transition tax was upheld in *Moore v. U.S.*, 602 U. S. __ (2024). In *Moore*, the taxpayers were investors in an Indian corporation. They owned at least 10% of the issued and outstanding shares of the corporation on the effective date of the tax. They paid transition tax in the amount of $14,729, after which they sued for a refund. In their view, the transition tax was an unconstitutional tax because it was not based on currently realized income. As such, the taxpayers contended the tax was a direct tax on property, which under the U.S. Constitution must be apportioned to each state based on the state's share of the total population of the nation. They further argued that the retroactive nature of the tax violated due process. Retained earnings as far back as 2006 were taxed.

Part of the reason for the attention surrounding the case was that a successful challenge could upend the entire C.F.C. regime, which depends on taxing U.S. shareholders of C.F.C.'s on their respective interests in the C.F.C. profits.

The Supreme Court rejected the arguments of the taxpayers and found that the tax was an income tax because income was realized at some point by the C.F.C. Congress has the power to determine whether the corporation generating the income or its shareholders should be taxed. The Supreme Court analogized to principles of partnership taxation, S-corporation taxation, and the rest of the

---

39 Code §965(h).

40 IR-2018-131 issued on June 4, 2018, announcing three additions to the I.R.S. Frequently Asked Questions on the transition tax.

C.F.C. regime, to conclude that the tax was an income tax and not a property tax.

d. U.S. Reduced Tax Rate Imposed on Global Intangible Low-Tax Income of C.F.C.'s

The T.C.J.A. enacts a global intangible low-taxed income ("G.I.L.T.I.") regime that is designed to decrease the incentive for a U.S.-based multinational groups to shift corporate profits to controlled subsidiaries based in low-tax jurisdictions.[41]

1) Computation of Tested Income Under the G.I.L.T.I. Regime

The G.I.L.T.I. regime applies to U.S. Shareholders of C.F.C.'s, as defined above. G.I.L.T.I. applies only to income that is not already taxed in the U.S. either at the level of a C.F.C. or its U.S. Shareholders. Consequently, it is an add-on tax imposed on profits that would have benefited from deferral under prior law.

The first step in computing G.I.L.T.I. is to eliminate the C.F.C.'s items of income that produce current tax.[42] These include the following items of income:

- Business income that is subject to net-basis taxation in the U.S.
- Dividends from a related C.F.C. that are not subject to tax in the U.S. at either the level of the C.F.C. or the level of its U.S. Shareholders because of Subpart F
- All other income of a C.F.C. that results in an immediate U.S. tax under Subpart F for its U.S. Shareholders

The remaining income is referred to as "Tested Income."

---

41 Code §951A.

42 Code §951A(c)(2)(A)(i).

2) Removal of Qualified Business Asset Income

In determining how much Tested Income is treated as G.I.L.T.I., actual economic drivers for generating income are ignored. Instead, all items of C.F.C. income are deemed to arise from either depreciable tangible property used in the business or intangible property used in the business.[43] Consequently, investment in inventory, work in progress, and supplies are lumped into the intangible category because they fail to meet the definition of depreciable tangible property. Similar treatment is provided for the financial assets of a bank that is a C.F.C.

The investment in tangible depreciable property is deemed to generate a 10% yield computed with reference to the adjusted basis of the property.[44] The amount so determined is reduced by interest expense allocated against the tangible depreciable property.[45] The balance of the income is attributable to intangible property, which in turn gives rise to G.I.L.T.I. for U.S. Shareholders of a C.F.C.

3) Netting of Tested Income

At this point, the positive and negative G.I.L.T.I. results for each C.F.C. owned by the same U.S. Shareholder are aggregated. The U.S. Shareholder reports the net amount of G.I.L.T.I. on its U.S. Federal tax return. The aggregate amount is then allocated to each C.F.C. with positive Tested Income.

4) Foreign Tax Credit Computations

When a U.S. Shareholder is a corporation, several additional computations are required:

---

43 Code §951A(b)(1).

44 Code §951(b)(2)(A).

45 Code §951(b)(2)(B).

- First, a deemed foreign tax credit is allowed for foreign income taxes attributable to G.I.L.T.I.[46] The starting point in determining those taxes is to identify the C.F.C.'s total foreign income taxes paid.

- Second, the foreign income taxes attributable to income not included in Tested Income are removed. Again, these are foreign income taxes attributable to Subpart F Income of the C.F.C. or income arising from a business conducted in the U.S. What remains are "Tested Foreign Tax Credits."

- Third, the portion of the total Tested Foreign Tax Credits that are attributable to the 10% yield on depreciable tangible property must be identified and removed from the pool. What remains are Tested Foreign Tax Credits attributable to G.I.L.T.I.

Because the foreign tax credit in this scenario relates to taxes actually paid by the C.F.C. but attributed to the corporate U.S. Shareholder – sometimes called a deemed-paid or indirect credit – the taxes for which the credit is claimed must be added to the amount otherwise reported as taxable. This is referred to as a gross-up.[47] Its purpose is to equate the deemed-paid credit to a direct foreign tax credit of a branch of the U.S. corporation. There, the payment of the creditable tax does not reduce taxable income – just as the Federal income tax does not reduce U.S. taxable income.

The foreign income taxes attributable to G.I.L.T.I. are placed in a separate foreign tax credit limitation basket. The separate basket ring-fences the income and creditable taxes so that the U.S. tax on G.I.L.T.I. cannot be offset by excessive taxes on income in other baskets. The amount of foreign taxes creditable to G.I.L.T.I. is then multiplied by an inclusion percentage (discussed below) and reduced by 20% so that only 80% of available foreign tax credits

---

46 Code §960(d).

47 Code §78.

attributable to G.I.L.T.I. are ultimately creditable.[48] This reduction has no effect on the gross-up under Code §78.

The inclusion percentage reflects the fact that the G.I.L.T.I. inclusion is determined by netting profitable G.I.L.T.I. operations of C.F.C.'s owned by the corporate U.S. Shareholder with unprofitable operations. Again, profitable operations and unprofitable operations are determined on an after-tax basis at the level of the C.F.C. The pool of available foreign tax credits must then be reduced to reflect the benefit of the netting computation. Consequently, the inclusion percentage is determined by dividing (i) the net G.I.L.T.I. inclusion reported by the corporate U.S. Shareholder by (ii) the gross Tested Income of all C.F.C.'s having positive Tested Income. Only foreign income taxes paid by subsidiaries that report positive G.I.L.T.I. may be claimed as an indirect foreign tax credit.

The foreign tax credit limitation is computed based on a 21% corporate income tax. To the extent foreign income tax on Tested Income tax cannot be credited by the corporate U.S. Shareholder in the year of the G.I.L.T.I. inclusion, the tax is lost forever. No carryback or carryforward is provided for unused G.I.L.T.I.-related foreign tax credits. Consequently, the lost taxes reflect each of the following computations:

- Application of 80% cap on the pool of available foreign taxes

- Foreign income taxes imposed on a C.F.C. that reports negative Tested Income on an after-tax basis

- Foreign income taxes in excess of the foreign tax credit limitation based on the 21% corporate tax rate in the U.S.

5) <u>50% Deduction for Corporate U.S. Shareholders</u>

Once the gross amount of G.I.L.T.I. is determined, a U.S. Shareholder that is a corporation is entitled to a 50% deduction

---

48 Code §960(d)(1).

based on the amount of G.I.L.T.I. included in income.[49] Because the rate of corporate tax in the U.S. is 21%, a corporate U.S. Shareholder's effective tax rate on G.I.L.T.I. will be 10.5%. If foreign taxes are available to be claimed as a credit, the effective rate of tax must take into account the 20% of deemed paid taxes that are not available for any credit. This makes the effective rate of U.S. tax 13.125%.

The deduction is not available to individuals. However, individuals may elect to create a silo of income and taxes with regard to G.I.L.T.I. Income in the silo can be taxed as if earned by a corporation.[50] The income in the silo is entitled to the 50% deduction,[51] as the legislative history of the T.C.J.A. describes the deduction as a "reduced rates" mechanism.[52] This characterization is important because an individual making the election to be taxed at corporate rates generally is not entitled to deductions, except as allowed in the provision allowing for the election.

e. <u>Foreign-Derived Intangible Income Deduction for Domestic Operating Income of U.S. Companies Related to the Exploitation of Foreign Markets</u>

At the same time the T.C.J.A. accelerated tax under the G.I.L.T.I. regime for certain profits derived abroad from active business operations, it also provided a deduction for U.S. corporations operating in the U.S. to expand sales of products and services abroad.[53] The deduction relates to foreign-derived intangible income

---

49 Code §250.

50 Code §962.

51 Prop Treas. Reg §1.962-1(b)(3).

52 See U.S. Congress, House of Representatives, Committee of Conference, *Conference Report on H.R. 1, Tax Cuts and Jobs Act,* 115th Cong., 1st sess., 2017, H. Rep. 115-466 at note 1515. See also note 1516, referring to the deduction as a method to reduce corporate tax rates.

53 Code §250.

("F.D.I.I.") and shares many of the technical concepts of the G.I.L.T.I. regime, albeit in the context of exports.

F.D.I.I. is the portion of a U.S. corporation's intangible income derived from serving foreign markets, determined by a formula. The F.D.I.I. of any U.S. corporation is the amount that bears the same ratio to the "deemed intangible income" of the corporation as its "foreign-derived deduction eligible income" bears to its "deduction eligible income."

Several new terms must be understood to compute the F.D.I.I. deduction:

- "Deemed intangible income" means all deduction eligible income in excess of "deemed tangible income" return.

- "Deemed tangible income" means a 10% return on the average basis in depreciable tangible property used in a trade or business and of a type for which a depreciation deduction is allowed.

- "Deduction eligible income" means, with respect to any U.S. corporation, the amount by which (i) gross income (excluding certain income items taxed in connection with operations conducted outside the U.S. directly or through a C.F.C.) exceeds (ii) allocable deductions (including taxes).

- "Foreign-derived deduction eligible income," means deduction eligible income derived in connection with property that is sold by the taxpayer to any person who is not a U.S. person. The sale must be made for use, consumption, or disposition outside the U.S. by the purchaser. If services, they must be provided by the taxpayer to any person not located in the U.S. or with respect to property not located in the U.S. The I.R.S. is given broad discretion in determining whether the taxpayer has met its burden of proof in establishing that property has been sold for use outside the U.S. or services have been performed for persons or with regard to property located outside the U.S.

- The terms “sold,” “sells,” and “sale” include any lease, license, exchange, or other disposition. “Foreign use” means any use, consumption, or disposition outside the U.S.

A U.S. corporation may claim a 37.5% deduction for the foreign-derived deduction eligible income when computing taxable income. The intent is to impose a 13.125% rate of tax on these profits.[54] This deduction is not available to individuals who operate a business through a limited liability company.

f. Base Erosion and Anti-Abuse Tax

The T.C.J.A. introduced a minimum tax provision for large corporations that significantly reduce their U.S. tax liability through the use of cross-border payments to related persons.[55] Known as the Base Erosion and Anti-Abuse Tax (the “B.E.A.T. Regime”), the provision is viewed to be an attack against inbound base erosion through intercompany service fees, interest, rents, and royalties (“Base Erosion Payments”)[56] paid to 25% foreign related persons.[57] The B.E.A.T. Regime generally applies to corporate taxpayers that have average annual gross receipts of $500 million or more during the testing period (the “gross receipts test”) and whose deductible payments to related parties equal or exceed 3% of their total allowed deductions (2% for certain banks and securities dealers).[58]

The B.E.A.T. Regime is not limited to U.S. corporations, but can also apply to foreign corporations with respect to income that is effectively connected with the conduct of a U.S. trade or business. However, for the purposes of determining whether a foreign corporation meets the gross receipts test, gross receipts are only

54 Code §250(a)(1)(A).

55 Code §59A.

56 Code §59A(d).

57 Code §59A(g).

58 Code §59A(e)(1).

included if they are taken into account when calculating the taxpayer's U.S. effectively connected income.

If applicable, the B.E.A.T. Regime compares a tax of 10% (5% in 2018) imposed on the modified taxable income of a U.S. corporation with the 21% tax imposed on regular taxable income. If the tax on modified taxable income exceeds the regular tax, the excess is added to the regular tax for the year.

Modified taxable income under the B.E.A.T. Regime is broader than the concept of taxable income for regular tax purposes.[59] It is determined by adding the following items of deductible expense to the corporation's taxable income:

- Deductions allocated to Base Erosion Payments in connection with payments made to 25% foreign related parties

- Depreciation and amortization deductions related to property purchased from 25% foreign related parties

- A specified portion of net operating losses from earlier years

For this purpose, a foreign entity is considered to be a 25% related foreign entity with regard to a corporation if it meets any of the following criteria:

- It is treated as owning shares in the U.S. corporation that represent at least 25% of the voting power or the value of all shares issued and outstanding.

- It is related to the corporation or to a 25% foreign owner of the corporation under constructive ownership rules similar to those discussed above that generally require more than 50% common ownership between two persons.

- It is treated as related to the taxpayer under the arm's length transfer pricing principles of U.S tax law. This means that

[59] Code §59A(c).

one party controls the other or they are both under common control, no matter how exercised.

Certain payments that reduce U.S. tax are expressly removed from coverage under the B.E.A.T. Regime. These include the purchase price for inventory[60] and certain services that are generally of a kind that can be charged to a related party without a mark-up over costs without running afoul of the arm's length transfer pricing rules of U.S. tax law.[61] The I.R.S. is authorized to issue regulations that are necessary to prevent the avoidance of the B.E.A.T. Regime. Examples of abusive transactions include the use of unrelated persons, conduit transactions, or other intermediaries, or transactions or arrangements in ways that are designed, in whole or in part, to improperly recharacterize payments for the purpose of avoiding the B.E.A.T. Regime.

g. <u>Limitations Placed on Business Interest Expense Deductions</u>

Prior to the T.C.J.A., U.S. subsidiaries of foreign corporations were subject to an earnings stripping rule that applied when interest was paid to related parties outside the U.S. in circumstances where withholding tax was reduced or eliminated.[62] A cap was placed on the deduction for interest expense paid to a related party where the full 30% withholding tax was not collected, typically under the terms of an income tax treaty. The cap applied when the total net interest expense exceeded 50% of what is essentially E.B.I.T.D.A. and the debt-to-equity ratio exceeded 1.5 to 1.

The T.C.J.A. modifies the scope of these rules so that a ceiling is placed on the deduction for all business interest expenses. For taxable years beginning after 2017, the deduction for business interest is limited to the sum of business interest income and 30% of what is essentially E.B.I.T.D.A. for the taxable year. The amount of

---

60 Preamble to REG-104259-18, Section III (Base Erosion Payments).

61 Code §59A(d)(5).

62 Code §163(j).

any business interest not allowed as a deduction for any taxable year may be carried forward indefinitely, subject to certain restrictions applicable to partnerships. Special rules exempt floor plan financing interest, which is typically used by automobile dealers,[63] as well as certain electing real property, farming, and utilities businesses, from the application of the 30% ceiling.[64]

Beginning in 2022, the ceiling is tightened by replacing the E.B.I.T.D.A. base with an E.B.I.T.-related base. Depreciation, amortization, and depletion are no longer added back to income when determining the base on which the 30% cap is computed.

Certain businesses are not covered by the ceiling. These include, *inter alia*, taxpayers with less than $25 million in average annual gross receipts for the period of three taxable years ending with the prior taxable year and electing real property trades or businesses.[65]

h. Other Revisions Affecting Cross-Border Groups

The T.C.J.A. made several other revisions to U.S. tax law affecting cross-border investors. The following list contains some of the more important changes:

- When valuing intangible property that is sold, transferred, or licensed to a related party, a taxpayer must consider realistic alternatives to the transaction as the methodology utilized by the taxpayer must apply the aggregate basis of valuation rather than an asset-by-asset method.[66]

- An exception to immediate gain recognition provided under prior law was eliminated,[67] resulting in the immediate recognition of gain in connection with a transfer of tangible

---

63 Code §163(j)(1)(C).

64 Code §163(j)(7)(A).

65 Code §§163(j)(3) and 448(c).

66 Code §482.

67 Code §367(a)(3) prior to enactment of the T.C.J.A.

assets used in an active trade or business to a related party outside the U.S.

i. Biden Tax Proposals

In late Spring 2021, the Biden Administration announced its tax policies to pay for a spending program on domestic infrastructure and other items..

The highlights of the Biden Administration tax proposals addressing cross-border taxation were as follows:

- The corporate tax rate would be increased to 28%.

- A 15% minimum tax would be imposed on book income of corporations reporting more than $2 billion of income for book purposes, as adjusted for certain items such as credits and book net operating losses.

- The anti-inversion rules would be strengthened by treating any acquisition of 50% or more ownership of a U.S. target or after the acquisition by a foreign corporation, the target continues to be managed or controlled by U.S. persons.

- The F.D.D.I. rules will be repealed and replaced by some form of research and development incentive targeted to U.S. activity.

- Both negative and positive incentives will be applied to grow jobs in the U.S. A 10% general business credit would be given for expenses incurred in connection with on-shoring of jobs. Expenses incurred in off-shoring of a U.S. trade or business would be nondeductible.

While many of the Biden Tax Proposals have not been enacted, they likely will be part of the next presidential election campaign.

j. U.S. Foreign Tax Credit Regulations – In General

New I.R.S. regulations were adopted at the end of 2021 that are designed to limit the ability of U.S. taxpayers to offset U.S. tax by a credit for digital services taxes and other taxes that are imposed under foreign law, based on the assertion that the location of the customers creates a digital presence in the country.

Under long-standing principles followed by the I.R.S., a foreign income tax for which a foreign tax credit is claimed under U.S. tax law must be structured so that it is imposed on the net gain of the taxpayer. Three tests must be met in order for a tax to meet the net gain requirement:

- The realization test
- The gross receipts test
- The net income test

Under the realization test, the tax must be imposed at the time when income is realized.[68] Under the gross receipts test, the tax must be imposed on gross receipts or the equivalent.[69] Under the net income test, the tax must be imposed on net income after allowing for the recovery of expenses through immediate deductions against income or amortization of the total expenditure over time.[70]

In addition to the historic tests, the new regulations require close conformity to U.S. tax law and an attribution requirement that examines the jurisdictional basis for imposing tax. A nexus must exist between the transaction and the authority of the foreign government to impose tax. If an appropriate nexus does not exist, the tax is not a creditable income tax. As a result, some foreign taxes that were creditable under prior regulations may no longer be claimed as a credit. One of three nexus tests must be met in order for a foreign tax to have jurisdictional nexus to tax income. The first is an activities test. It broadly mirrors activities that would cause the income of a foreign enterprise to be taxed in the U.S. as effectively

---

68 Treas. Reg. §1.901-2(b)(2)(i).

69 Treas. Reg. §1.901-2(b)(3).

70 Treas. Reg. §1.901-2(b)(4)(i).

connected income.[71] The second test is a source of income test. Under that test, the income that is taxed by the foreign country must be based on source rules that are similar to those in the U.S. that are applied to foreign enterprises providing services in the U.S. or licensing intangible property for use in the U.S.[72] The third test is based on the location of property. For a tax on the disposition of real property to be creditable, the income or gain must be taxed by the foreign country based on concepts similar to those of F.I.R.P.T.A. For a tax on the disposition of personal property to be creditable, the income or gain must be taxed by the foreign country because it is business property of an office or fixed place of business of the enterprise in the country.[73]

The regulations take particular aim at taxes imposed under destination-based criteria, such as the location of a company's customers. This typically addresses digital services taxes which are imposed based on the location of the customer base.

k. U.S. Foreign Tax Credit Regulations – Pillar Two

On December 11, 2023, the I.R.S. issued Notice 2023-55 (the "Notice"), announcing the intention to issue proposed regulations addressing the interaction between the Pillar Two GloBE Rules and specific U.S. tax provisions, including the foreign tax credit rules and dual consolidated loss rules. Pillar Two establishes a top-up tax framework through the GloBE rules, which consists of the Income Inclusion Rule ("I.I.R.") and the Undertaxed Payments Rule ("U.T.P.R."). The issuance of this guidance is timely, as the I.I.R.'s of most countries took effect at the start of 2024, while the U.T.P.R.'s are scheduled to come into effect in 2025. The Notice does not cover the U.T.P.R.

The Notice describes rules addressing the treatment of certain taxes, including the I.I.R., U.T.P.R., and Q.D.M.T.T., under Code §§59(l), 78, 275, 704, 901, 903, 951A, 954, and 960. Code §901 generally

---

71 Treas. Reg. §1.901-2(b)(5)(i)(A).

72 Treas. Reg. §1.901-2(b)(5)(i)(B).

73 Treas. Reg. §1.901-2(b)(5)(i)(C).

allows a credit for foreign income taxes paid or accrued during the taxable year to any foreign country or U.S. territory, and in the case of a domestic corporation, the taxes deemed to have been paid under Code §960 in connection with Subpart F income and G.I.L.T.I. income generated by a C.F.C. Code §903 allows a credit for a foreign tax paid in-lieu-of a generally imposed income tax. Code §59(l) provides a corporate alternative minimum foreign tax credit. Code §275 addresses taxes that are not deductible when computing taxable income.

The rules are expected to have adverse implications for U.S. taxpayers, as both the I.I.R. and the U.T.P.R. are likely to be non-creditable for U.S. tax purposes.

A foreign income tax is a "final top-up tax" if the foreign tax law takes into account taxes imposed by other countries on the entity's direct or indirect owners or on the entity itself for income earned in the foreign country. No credit is allowed under Code §§901 or 59(l) to a person for a final top-up tax if the foreign tax law takes into account any U.S. Federal income tax liability in computing the final top-up tax (without regard to whether the person has any amount of U.S. Federal income tax liability).

The final top-up tax is treated as if it were a creditable tax at the partnership and C.F.C. level, with the disallowance of the credit applying at the partner or U.S. shareholder level. This treatment is intended to facilitate appropriate results where a final top-up tax is creditable as to one partner or U.S. shareholder, but not as to another. Moreover, a final top-up tax is not taken into account in determining whether the high-tax exception under Subpart F or G.I.L.T.I. applies.

Specifically:

- A final top-up tax is treated as a creditable foreign tax expenditure under Treas. Reg. §1.704-1(b)(4)(viii)(b).

- A final top-up tax is treated as an eligible current year tax under Treas. Reg. §1.960-1(b)(5).

- In computing the effective rate of foreign income tax under Treas. Reg. §§1.954-1(d)(2) and 1.951A-2(c)(7)(vi), a final top-up tax is excluded from the amount of foreign income taxes described in Treas. Reg. §§1.954-1(d)(2)(i) and 1.951A-2(c)(7)(vi)(A). In addition, it increases the amount of the net item of income described in Treas. Reg. §1.951-1(d)(2)(ii) and the amount of the tentative tested income item described in Treas. Reg. §1.951A-2(c)(7)(vi)(B), as applicable.

If a taxpayer chooses to claim a foreign tax credit, the gross-up rule of Code §78 and the deduction disallowance rule of Code §275(a)(4) apply to any foreign income tax paid or accrued, including a final top-up tax. Code §78 requires a taxpayer to include a final top-up tax in gross income and Code §275(a)(4) denies a deduction for a final top-up tax.

The Notice provides that the I.R.S. and the Treasury Department intend to issue proposed regulations regarding how the separate levy rules of Treas. Reg. §1.901-2(d) apply with respect to an I.I.R., U.T.P.R., and Q.D.M.T.T. This treatment would reflect that the amount of tax imposed under an I.I.R., U.T.P.R., or Q.D.M.T.T. is computed separately from any other levy imposed by a foreign country and would ensure consistent treatment of an I.I.R., U.T.P.R., and Q.D.M.T.T. no matter how a foreign country constructs an I.I.R., U.T.P.R., or Q.D.M.T.T. Consequently, it does not matter whether the foreign country imposes these taxes independently or by adjusting the base of any other levy (such as through an addition to income or denial of deductions).

The Notice provides that the I.R.S. and the Treasury Department intend to issue proposed regulations establishing rules for determining the company deemed to be the payer of a Q.D.M.T.T. for purposes of Treas. Reg. §1.901-2(f) when a Q.D.M.T.T. is computed by reference to the income of two or more companies.

If a Q.D.M.T.T. is computed by reference to the income of two or more persons, foreign tax law is considered to impose legal liability for the Q.D.M.T.T. on each person in proportion to the person's Q.D.M.T.T. Allocation Key, as defined.

l. GloBE and Dual Consolidated Loss Limitation Rules

The Notice also addresses the interplay of the GloBE rules and the dual consolidated loss ("D.C.L.) rules of Code §1503(d). The rules aim to prevent "double dipping" of losses where the same economic loss offsets both U.S. taxable income and foreign taxable income.

Under the D.C.L. rules, a D.C.L. generally cannot offset the income of a domestic affiliate. An exception allows domestic use of a D.C.L. if the taxpayer makes a domestic use election, certifying no foreign use of the D.C.L. Foreign use occurs when any portion of the D.C.L. is used to offset income under a foreign country's tax laws. If foreign use happens during the certification period, the taxpayer must recapture the D.C.L. as ordinary income and pay interest on the deferred U.S. tax.

Under the GloBE rules, if an M.N.E. Group's E.T.R. for a jurisdiction is below the 15% minimum rate, it needs to calculate the Jurisdictional Top-up Tax owed for that jurisdiction. This tax is determined based on factors like Adjusted Covered Taxes and the Net GloBE Income of constituent entities within the jurisdiction.

The GloBE rules adopt a jurisdictional blending approach, where all income and loss of constituent entities in the same jurisdiction are generally combined. That aggregation raises concerns similar to those the D.C.L. rules were designed to address. For instance, if a loss resulting in a D.C.L. is combined with items that, according to U.S. tax principles, belong to a foreign corporation in that jurisdiction, the loss could be used to offset both U.S. tax (if a domestic use election is allowed) and the Jurisdictional Top-up Tax.

The I.R.S. is examining how the D.C.L. rules should apply to the GloBE rules. This includes looking at whether combining certain items through aggregation leads to a foreign use of a D.C.L. The I.R.S. is also assessing whether the GloBE rules should classify an entity not otherwise subject to a foreign jurisdiction's income tax as a dual resident corporation or a hybrid entity under Treas. Reg. §§1.1503(d)-1(b)(2) or (3).

Additionally, the I.R.S. and the Treasury Department are considering whether these rules should prevent an entity from being treated as a transparent entity under Treas. Reg. §1.1503(d)-1(b)(16).

Finally, the I.R.S. is exploring similar issues in the context of other provisions, such as how the anti-hybrid rules under Code §§245A(e) and 267A interact with the GloBE rules.

m. Budget Resolution Tax Provisions Aimed at O.E.C.D. Proposals

In spring 2025, the U.S. House of Representatives adopted a budget resolution containing provisions that would impose increased taxes for persons based in countries that impose taxes found to discriminate against U.S. companies or their subsidiaries.[74] In broad terms, if a country is determined to have "crossed the line," residents of that country and their subsidiaries would face up to a 20% increase in withholding taxes on U.S.-source investment income and taxes on income that is effectively connected to the conduct of a U.S. trade or business. The tax increase will be effected in 5-percentage point increments over a four-year period beginning in 2026, ultimately resulting in a 20-point increase in tax.

The provision is intended to have broad application, covering the following persons and entities:

- Foreign governments, sovereign wealth funds, and public agencies of countries designated as discriminatory foreign countries

- Individuals and legal entities (including corporations, partnerships, trusts, and foundations) that are resident in, established in, or effectively managed in a discriminatory foreign country

---

[74] Proposed Code §899.

- Entities that are substantially owned or controlled, directly or indirectly, by any of the above persons after application of broad ownership-by-attributions rules

Tax regimes that are expressly considered to be discriminatory include the following:

- **Taxes that implement the Undertaxed Profits Rule of the O.E.C.D.** These taxes are designed to ensure a global minimum tax of 15%, which is primarily enforced by an income inclusion rule at the parent level of a group, and secondarily enforced by an income inclusion rule or a deduction disallowance rule wherever the multinational group operates.

- **Digital Services Taxes on revenues earned by large multinational digital companies.** These taxes are imposed on activities such as online advertising, operation of digital marketplaces, and user data sales. They target companies that generate significant revenue from users in a country without having a physical presence in that country.

- **Diverted Profits Taxes designed to counteract aggressive tax planning within multinational groups.** From the viewpoint of the country in which the customer is based, the tax targets arrangements that divert profits to a low-tax jurisdiction, often through complex structures or transactions lacking genuine economic substance.

In general, the implementation date for imposing the tax increase against a particular foreign jurisdiction is the first day of the calendar year following the year in which the latest of the following events occurs:

- 90 days after the enactment, which generally targets persons in jurisdictions that have already adopted a targeted foreign tax

- 180 days after the enactment of an unfair foreign tax, which generally targets persons in jurisdictions that adopt a discriminatory foreign tax after the 90-day period mentioned above

- The initial effective date of the unfair foreign tax, which generally targets persons in jurisdictions that adopt a targeted foreign tax

Withholding agents will not be penalized for under-withholding regarding amounts paid prior to 2027, subject to a good faith requirement.

In addition to income taxes and withholding taxes on investment income, several other taxes will be increased if the measure is adopted in present form. They include

- Code 59A (Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts),
- Code §884 (Branch Profits Tax),
- Code §897 (Disposition of Investment in United States Real Property),
- Code §1441 (Withholding of Tax on Nonresident Aliens),
- Code §1442 (Withholding of Tax on Foreign Corporations),
- Code §1443 (Foreign Tax-Exempt Organizations),
- Code §1445 (Withholding of Tax on Dispositions of United States Real Property Interests),
- Code §1446 (Withholding of Tax on Foreign Partners' Share of Effectively Connected Income), and
- Code §4948 (Application of Taxes and Denial of Exemption With Respect to Certain Foreign Organizations).

The Senate proposed a similar version to the House bill. In the Senate bill, the additional tax is capped at 15%, the increase in withholding tax would not affect the portfolio debt provisions of

U.S. tax law,[75] and the effective date is deferred. The differences between the two bills are not significant and the provision will likely be adopted as part of a larger compromise package.

Faced with a unified front in the Congress and the Administration, the O.E.C.D. negotiated a truce. U.S. companies will be excluded from Pillar Two coverage. In turn, proposed Code §899 has been removed from the budget reconciliation proposals.

The arrangement does not address the D.S.T. and the D.P.T., two taxes that may trigger the application of Code §891. Enacted in 1934, The provision doubles the rate of U.S. income taxes on citizens and corporations of a foreign country that has adopted tax rules that subject U.S. citizens or corporations to that discriminatory

---

[75] The portfolio debt provisions eliminate withholding tax that is imposed on nonresident, noncitizen individuals and foreign corporations that receive U.S. source interest income when certain conditions are met. See Code §§871(h) for payments to nonresident, noncitizen individuals and 881(c)(2) for foreign corporations.

or extraterritorial taxes.[76] Code §891 has never been invoked by a sitting president although its application has been threatened once.[77]

n. Path Forward

Until this point, this article has looked in general at the challenges faced in cross-border tax planning in Europe and under the B.E.P.S. Project, and in a focused way, in the U.S. under the T.C.J.A. The

---

76 Code §891 (Doubling of Rates of Tax on Citizens and Corporations of Certain Foreign Countries.) In pertinent part, it provides as follows:

> Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax imposed by section 1, 3, 11, 801, 831, 852, 871, and 881 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country; but the tax at such doubled rate shall be considered as imposed by such sections as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 percent of the taxable income of the taxpayer (computed without regard to the deductions allowable under section 151 and under part VIII of subchapter B).

77 See Joseph J. Thorndike, "Tax History: Threats, Leverage, and the Early Success of Reprisal Taxes," Tax Notes (March 21, 2016), at https://www.taxnotes.com/tax-history-project/tax-history-threats-leverage-and-early-success-reprisal-taxes/2016/03/21/g3kq.

balance of this article will examine the challenges now faced by tax planners within Europe.

We begin with a detailed look at how the B.E.P.S. Project has affected tax plans and how the European Commission is applying the concept of unlawful State Aid and the Anti-Tax Avoidance Directives to challenge sophisticated cross-border plans to achieve tax savings that were valid until just a few years ago. The article then proceeds to examine the tax treatment of companies in each of 17 European jurisdictions.

The goal is to determine whether a particular European country provides tax treatment – alone or in conjunction with a second jurisdiction – that makes the formation of a holding company attractive to a U.S.-based group of companies. It must be staffed with competent persons having authority to make decisions and must avoid being a conduit to the U.S. parent.

For many U.S. planners advising corporate groups, this represents a major change of thinking, as the group's substance is frequently attributed to all group members – even those having no employees. This view is evident in the limitation on benefits article in U.S. income tax treaties where subsidiaries of publicly traded corporations qualify for treaty benefits and in determining whether a company is actively engaged in a trade or business, activities of a parent company or a 50% affiliate are attributed to the company.

However, in Europe, a company with no employees or activities is just a shell company. In today's world, tax benefits must be seen as non-abusive and business plans must be generated by operational personnel rather than tax advisers. A structure that is recommended based solely on an arithmetical rate of tax – net income multiplied by a low corporation tax rate – will likely face unpleasant surprises on both sides of the Atlantic.

3. B.E.P.S. AND HOLDING COMPANIES[1]

A. Background

The B.E.P.S. Project is the name for today's most conceptually dense international tax reform proposal, and behind the acronym lies the hidden meaning of base erosion and profit shifting.

This project marks a sea change for some and the dawn of an improved system of international tax justice for others, especially academics and tax authorities. The B.E.P.S. Project originates from the meeting of government finance ministers and central bank governors from 20 major economies (the "G-20") in Moscow in 2013. The accompanying communiqué[1] pointed out that globalization had damaged many states' core sovereignty, *i.e.*, their capacity to legitimately levy a compulsory tax on income produced by their residents. As observed later in 2013 by the O.E.C.D., the interaction of independent sets of rules enforced by sovereign countries creates friction, including potential double taxation for corporations operating in several countries, and it can also create gaps in cases where corporate income is not taxed at all, either by the country of source or by the country of residence, or where it is taxed only at nominal rates.[2]

Even if the development of bilateral tax treaties can solve the problem of double taxation, it is clear that gaps still remain at present. Cases of tax evasion by large multinational enterprises ("M.N.E.'s") and the international financial crisis made states eager to prevent practices that enable B.E.P.S., and citizens have also become more sensitive to issues of tax fairness.

---

1 This chapter of the article was written by Paul Kraan of Van Campen Liem based in part on material originally prepared by Eric Fort, of Arendt & Medernach, Luxembourg.

1 Communiqué of February 16, 2013.

2 O.E.C.D. (2013), *Action Plan on Base Erosion and Profit Shifting*, O.E.C.D. Publishing.

Consequently, the G-20 mandated the O.E.C.D. to develop an action plan to address the B.E.P.S. issues and propose solutions. In particular, the action plan was intended to provide states with domestic and international instruments with which they could address these anticompetitive practices by M.N.E.'s and restore a sense of legitimacy in the source of taxation.

B. B.E.P.S. Action Plan

On July 19, 2013, the O.E.C.D. published the B.E.P.S. Action Plan,[3] addressing perceived flaws in international tax rules and transfer pricing rules, which were previously studied in a report released in February 2013.[4] The B.E.P.S. Action Plan proposed 15 measures to combat various forms of B.E.P.S. In addition to the February report, the Action Plan identifies elements of concern in relation to double nontaxation or low taxation and proposes concrete actions with deadlines for compliance.

The actions are organized around three main pillars:

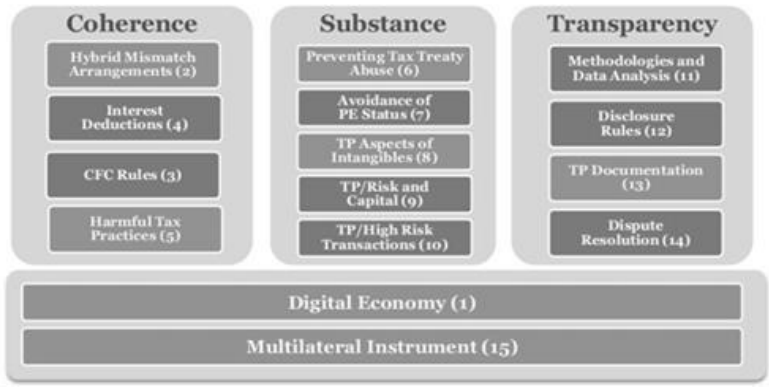
- Coherence of corporate tax at the international level
- Substance and realignment of taxation
- Transparency coupled with certainty and predictability

Aside from these pillars, the B.E.P.S. Action Plan also calls for the redressing of harmful practices in the digital economy and for the development of a multilateral instrument to implement the foregoing measures.

---

3 *Id.*

4 O.E.C.D. (2013), *Addressing Base Erosion and Profit Shifting*, O.E.C.D. Publishing.



Overall, the Action Plan sets out how current cross-border taxation rules may create opportunities for B.E.P.S., thereby resulting in a reduction of tax.

As an initial response, the O.E.C.D. Committee on Fiscal Affairs adopted a preliminary set of seven reports and recommendations, which it published on September 16, 2014. This work reflected the view that different stakeholders must participate in the initiative. Developing countries and other nonmember economies of the O.E.C.D. and the G-20 were consulted at numerous meetings and forums. In addition, business representatives, trade unions, banks, academics, and civil society organizations were given the opportunity to express themselves by commenting on discussion papers published by the O.E.C.D.

On October 5, 2015, the O.E.C.D. delivered a final package of 13 reports (the "Final Recommendations"), including the 2014 reports, to its members and the G-20.

Endorsed unanimously by the G-20 during their November 2015 meeting, the Final Recommendations contain the following set of guidelines:

- **Action Item 1:** Addressing the Tax Challenges of the Digital Economy

- **Action Item 2:** Neutralizing the Effects of Hybrid Mismatch Arrangements

- **Action Item 3:** Designing Effective Controlled Foreign Company Rules

- **Action Item 4:** Limiting Base Erosion Involving Interest Deductions and Other Financial Payments

- **Action Item 5:** Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

- **Action Item 6:** Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

- **Action Item 7:** Preventing the Artificial Avoidance of Permanent Establishment Status

- **Action Items 8-10:** Aligning Transfer Pricing Outcomes with Value Creation

- **Action Item 11:** Measuring and Monitoring B.E.P.S.

- **Action Item 12:** Mandatory Disclosure Rules

- **Action Item 13:** Guidance on Transfer Pricing Documentation and Country-by-Country Reporting

- **Action Item 14:** Making Dispute Resolution Mechanisms More Effective

- **Action Item 15:** Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

As described in the explanatory statement released with the Final Recommendations, these measures range from new minimum standards (*e.g.,* Action Item 5, Action Item 6, Action Item 13, and Action Item 14) to the revision of existing standards (*e.g.,* Action Item 7 and Action Items 8-10), common approaches which will facilitate the convergence of national practices (*e.g.,* Action Item 2, Action Item 3, Action Item 4, and Action Item 12), and guidance for the implementation of best practices (*e.g.,* Action Item 1, Action Item 11, and Action Item 15).[5]

Compliance with the minimum standards is ensured via the peer reviews by O.E.C.D. members and the G-20 in accordance with a more in-depth framework.

Despite constituting soft law, the Final Recommendations are being or have been implemented by the G-20, European countries, and others.

C. Reflecting a Sea Change in Acceptable Tax Planning

The B.E.P.S. Project demonstrates the passage from a system highlighted by individual competition among states for the greater good of one state to a system of international cooperation that reflects fiscal harmony, rather than abusive practices by certain operators. Cynics might say that the change is one in which smaller economies that thrived on arrangements to reduce tax in other countries will be required to reshape their economies to focus on more productive endeavors.

In calling for an internationally coordinated response, the B.E.P.S. Project requires support from each state at the domestic level. Each state retains its fiscal sovereignty and is free to apply the measures proposed by the O.E.C.D. on different terms, as long as it does not go against its international legal commitments. Thus, an adjustment period may be required in order to renegotiate tax treaties or to amend domestic law. At the same time, the O.E.C.D. created a mandate through Action Item 15 that called for an international conference to develop a multilateral instrument to amend the network of existing bilateral tax treaties in order to implement the B.E.P.S. Project's treaty measures all at once (the "M.L.I."). On November 24 and 25, 2016, negotiations regarding the M.L.I. among over 100 jurisdictions were concluded and a signing

5 O.E.C.D. (2015), *Explanatory Statement*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D.

ceremony was held on June 7, 2017, in Paris. The M.L.I. now covers around 1,900 bilateral tax treaties worldwide.

Even though the Final Recommendations have no binding legal authority, they reflect a global consensus as to best practices, and for that reason, they may be relied upon by tax authorities when challenging certain transactions or arrangements as abusive. Consequently, the real impact of the B.E.P.S. Project may already exist, even if national measures have not yet been fully implemented.

D. Effects on Holding Company Structures

In this respect, M.N.E.'s that use single purpose holding companies in global structures should be mindful of the B.E.P.S. Action Plan. The ground rules under which plans were proposed and implemented in the past may not provide useful guidance in the future.

The B.E.P.S. Project affects the fiscal engineering surrounding the different levels of involvement of a typical holding structure, and especially around holding companies, financing companies, and I.P. holding companies.

The B.E.P.S. Actions described below present the uses of B.E.P.S by holding companies in every form and indicate how the O.E.C.D. intends to tackle such practices.

E. B.E.P.S. Action 1: Addressing the Tax Challenges of the Digital Economy

The 2015 B.E.P.S. Action 1 Report[6] focusses on the tax challenges of the digitalization of the economy and is driven by the idea that in

6 O.E.C.D. (2015), Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report, O.E.C.D./G20 Base Erosion and Profit Shifting Project, O.E.C.D. Publishing, Paris.

the digital age, the allocation of taxing rights can no longer be exclusively circumscribed by reference to physical presence.

On May 29, 2019, the O.E.C.D./G-20 Inclusive Framework on B.E.P.S. approved the *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*[7] (the "*Programme*"), which is intended to be a roadmap for resolving the tax challenges arising from the digitalization of the economy providing for a process in order to reach a new global agreement for taxing multinational enterprises. The *Programme* foresees two main pillars:

- Pillar one[8] for the allocation of taxation rights (revised nexus and profit allocation rules)

- Pillar two[9] concerning a minimum level of tax (*global anti-base erosion proposal*)

On October 14, 2020, the O.E.C.D./G-20 Inclusive Framework on B.E.P.S. published the two reports on the Pillar One Blueprints[10] and the Pillar Two Blueprints[11] (the "Blueprints") and sought public comments.

---

7 O.E.C.D. (2019), *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, O.E.C.D./G-20 Inclusive Framework on B.E.P.S., O.E.C.D., Paris.

8 *Programme*, p. 9 *et seq.*

9 *Programme*, p. 25 *et seq.*

10 O.E.C.D. (2020), *Tax Challenges Arising from Digitalization – Report on Pillar One Blueprints*, O.E.C.D./G-20 Inclusive Framework on B.E.P.S., O.E.C.D., Paris (the "Pillar One Blueprint").

11 O.E.C.D. (2020), *Tax Challenges Arising from Digitalization – Report on Pillar One Blueprints*, O.E.C.D./G-20 Inclusive Framework on B.E.P.S., O.E.C.D., Paris (the "Pillar Two Blueprint").

On October 1, 2021, 137 jurisdictions released a joint statement[12] establishing a framework for Pillar One and Pillar Two. Not all Inclusive Framework members have joined as of June 23, 2023.

On December 1, 2021, the O.E.C.D. released model rules under Pillar Two[13] for establishing a global minimum tax. On March 14, 2022, the O.E.C.D. released detailed technical guidance on the Pillar Two model rules, including commentary[14] on the global anti-base erosion model rules with illustrative examples,[15] and sought public comments.

Since 2022, the O.E.C.D. sought and received public comments on various aspects of Pillar Two. Between 2023 and 2024, the O.E.C.D. issued further administrative guidance on Pillar Two.[16]

Since 2022, the O.E.C.D. sought and received public comments on several aspects of the draft rules for (i) Amount A under Pillar One (including nexus and revenue sourcing, tax base determinations, scope, extractives exclusion, regulated financial services exclusion, tax administration and tax certainty, and multilateral convention provisions on digital services taxes) as well as (ii) Amount B of

---

[12] O.E.C.D. (2021), *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy.*

[13] O.E.C.D. (2021), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two).*

[14] O.E.C.D. (2022), *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two).*

[15] O.E.C.D. (2022), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples.*

[16] O.E.C.D. (2023), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two*).

Pillar One. In 2024, the O.E.C.D. published a final report on Amount B of Pillar One.[17]

i. Pillar One

The different approaches discussed under pillar one have the following aspects in common:[18]

- Reallocation of taxing rights in favor of the user/market jurisdiction

- A new nexus rule that would not depend on physical presence in the user/market jurisdiction

- Going beyond the arm's length principle and departing from the separate entity principle

- Striving towards simplicity, stabilization of the tax system, and increased tax certainty in implementation

On October 9, 2019, the O.E.C.D. published a public consultation document[19] describing the "Unified Approach" under Pillar One and on October 14, 2020, the O.E.C.D. published the Pillar One Blueprint, according to which the key features for a common solution should be as follows:

- **Scope**: In addition to automated digital services, consumer-facing businesses should be within the scope of the provision. However, sectors not in scope include notably

---

17 O.E.C.D. (2024), *Pillar One - Amount B: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project.*

18 Public consultation document, Secretariat Proposal for a "Unified Approach" under Pillar One, 9 October 2019 – 12 November 2019, p. 4.

19 Public consultation document, Secretariat Proposal for a "Unified Approach" under Pillar One, 9 October 2019 – 12 November 2019.

extractive industries; certain financial services; construction; sale and leasing of residential properties; and international air and shipping businesses. Additionally, the Pillar One Blueprint provides that below two revenue-based thresholds (*i.e.*, a "global revenue" threshold based on the annual consolidated group revenue[20] and a "*de minimis* foreign in-scope revenue" threshold), the rules do not apply.

- **New Nexus**: Nexus based on sales in excess of certain thresholds. In relation to consumer-facing businesses, a "plus factor" to indicate a significant and sustained engagement with the market (*e.g.*, a subsidiary or a "fixed place of business") should be considered in order to achieve a Nexus. Nexus is not dependent on physical presence. The new nexus should be designed as a new self-standing provision.

- **Tax Base Determination**: The tax base is determined on the basis of the profits of a group (rather than on a separate entity basis).

- **New Profit Allocation Rule going beyond the Arm's Length Principle**: Irrespective of an in-country marketing or distribution presence in the form of a permanent establishment or separate subsidiary or sales made via unrelated distributors. A three-step formulaic approach should identify the quantum of Amount A to be allocated to a business's marketing jurisdictions by applying (i) a "profitability threshold," (ii) a "reallocation percentage," and (iii) an "allocation key."

- **Elimination of Double Taxation**: A mechanism that reconciles the new taxing right and the existing profit allocation rules is necessary to prevent double taxation by identifying the jurisdiction that must relieve double taxation.

20 For example, the €750 million revenue threshold used for country-by-country reporting requirements.

- **A Three-Tier Profit Allocation Mechanism:**

    - **Amount A**: The adoption of a new taxing right for the market jurisdiction, giving it a share of a *deemed residual profit* by using a formulaic approach.

      The deemed residual profit would be the profit that remains after allocating what would be regarded as a *deemed routine profit* on activities to the countries where the activities are performed.[21]

    - **Amount B**: A fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction.

      Activities in market jurisdictions, and in particular distribution functions, remain taxable according to existing rules regarding transfer pricing under the arm's length principle and permanent establishment allocations of profit. However fixed remuneration should be used reflecting an assumed baseline activity. A precise definition of activities qualifying for the fixed return is yet to be determined.

    - **Amount C**: Given the double taxation risks inherent in Amount A, it is intended to determine and implement a legally binding and effective dispute prevention and resolution method which would operate on a multilateral basis.

The framework for Pillar One released in 2021 includes the following main points:

- Companies included in the scope of Pillar One are multinational enterprises ("M.N.E.'s") with global turnover above €20 billion and profitability above 10%. The turnover

21 Public consultation document, Secretariat Proposal for a "Unified Approach" under Pillar One, 9 October 2019 – 12 November 2019.

threshold will be reduced to €10 billion, contingent upon the successful implementation of tax certainty on Amount A. The relevant review would begin seven years after the agreement comes into force, and the review would have to be completed in no more than one year. Extractives and regulated financial services are excluded.

- A special purpose nexus rule will allocate Amount A to a market jurisdiction when the affected M.N.E. derives at least €1 million in revenue from that jurisdiction. For smaller jurisdictions with a G.D.P. under €40 billion, the nexus will be set at €250,000. The special purpose nexus rule will apply to determine whether a jurisdiction qualifies for the Amount A allocation.

- For affected M.N.E.'s, 25% of their residual profit, defined as profit in excess of 10% of revenue, will be allocated to market jurisdictions with nexus using a revenue-based allocation key. The profit or loss of the affected M.N.E. will be determined by its financial accounting income, with adjustments. Losses will be carried forward. Where the residual profits of an affected M.N.E. are already taxed in a market jurisdiction, a marketing and distribution profits safe harbor rule will cap the residual profits allocated to the market jurisdiction through Amount A.

- Double taxation of profit allocated to market jurisdictions will be relieved using either the exemption or credit method. Tax liability will be drawn from those entities that earn residual profit. Affected M.N.E.'s will benefit from dispute prevention and resolution mechanisms.

- The work on Amount B and the application of the arm's length principle to in-country baseline marketing and distribution activities.

- A Multilateral Convention ("M.L.C.") will require all parties to remove all digital services taxes and commit to not introducing such measures in the future.

To implement Pillar One, the O.E.C.D. will develop the M.L.C. and an explanatory statement, model rules for domestic legislation, and the related commentary through which Amount A will be implemented.

In 2022 and 2023, the O.E.C.D. sought and received public comments on the following aspects of Pillar One:

- **Draft rules for nexus and revenue sourcing under Amount A under Pillar One.**[22] These rules will be outlined in Title 4 of the model rules and incorporated into the M.L.C. and its explanatory statement. To determine whether a group satisfies the nexus test for Amount A in a jurisdiction, it will have to apply the revenue sourcing rules by identifying the market jurisdiction for a given type of revenue: finished goods, components, services, intangible property, real property, government grants, and non-customer revenues.

- **Draft rules for tax base determinations under Amount A under Pillar One**.[23] These rules will be outlined in Title 5 and in Title 9 (definitions) of the model rules and will be incorporated into the M.L.C. and explanatory statement. The model rules on tax base are designed to calculate the profit (or loss) of a group for the purposes of determining Amount A, based on the consolidated group financial accounts. The starting point will be the consolidated profit and loss statement, but certain book-to-tax adjustments, adjustments with respect to profit (or loss) restatements in relation to prior periods, and loss carry forward rules will apply.

[22] O.E.C.D. (2022), *Public consultation document, Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing.*

[23] O.E.C.D. (2022), *Public consultation document, Pillar One – Amount A: Draft Model Rules for Tax Base Determinations.*

- **Draft rules for scope under Amount A under Pillar One.**[24] These rules will be outlined in Title 2 and in Title 9 (definitions) of the model rules and will be incorporated into the M.L.C. and explanatory statement. The model rules on scope determine when a group will be included in the scope of Amount A and subject to the detailed provisions contained within the model rules.

- **Extractives exclusion under Amount A under Pillar One.**[25] These rules will exclude the profits from extractive activities from the scope of Amount A. Extractive activities are defined by reference to two cumulative elements: a "product test" and an "activities test."

- **Regulated financial services exclusion under Amount A under Pillar One.**[26] These rules will exclude the revenues and profits of the following categories of regulated financial institutions from the scope of Amount A:

    - Depositary institutions
    - Mortgage institutions
    - Investment institutions
    - Insurance institutions
    - Asset managers
    - Mixed financial institutions

---

24 O.E.C.D. (2022), *Public consultation document, Pillar One – Amount A: Draft Model Rules for Domestic Legislation on Scope.*

25 O.E.C.D. (2022), *Public consultation document, Pillar One – Amount A: Extractives Exclusion.*

26 O.E.C.D. (2022), *Public consultation document, Pillar One – Amount A: Regulated Financial Services Exclusion.*

- Regulated financial institution service entities

The definition for each type of regulated financial institution generally contains three cumulative elements: a licensing requirement, a regulatory capital requirement, and an activities requirement.

- **Tax certainty aspects of Amount A under Pillar One, including a tax certainty framework for Amount A[27] and a tax certainty process for issues related to Amount A.[28]** The framework guarantees certainty for affected groups over all aspects of the new rules, including the elimination of double taxation. The process for resolving issues set out a mandatory and binding mechanism that will be used to resolve transfer pricing and permanent establishment profit attribution disputes that competent authorities are unable to resolve through the mutual agreement procedure ("M.A.P.") within two years of the presentation of the case to the competent authorities. The related rules will be incorporated into the model rules, the M.L.C., or other agreements and tools as needed.

- **Progress report on Amount A.[29]** The report includes a consolidated version of the operative provisions on Amount A (presented in the form of domestic model rules) reflecting the technical work completed so far.

---

27 O.E.C.D. (2022), *Public consultation document, Pillar One – A Tax Certainty Framework for Amount A.*

28 O.E.C.D. (2022), *Public consultation document, Pillar One – Tax certainty for issues related to Amount A.*

29 O.E.C.D. (2022), *Public consultation document, Progress Report on Amount A of Pillar One.*

- **Progress report on the tax administration and tax certainty aspects of Pillar One.**[30] The report contains draft rules on the administration of the new taxation rights as well as provisions on tax certainty. In particular, Part I of the report covers the administration process for Amount A, from the filing of the relevant information to payment of tax and access to timely relief from double taxation.

- **Draft M.L.C. provisions on digital services taxes and other relevant measures.**[31] This consultation document contains draft M.L.C. provisions implementing the rules for digital services taxes and other relevant measures, including (i) an obligation to withdraw the measures listed in an annex to the M.L.C. and stop applying them to any company, (ii) a definition of the measures the parties to the M.L.C. will commit not to enact in the future, and (iii) a mechanism that will eliminate Amount A allocations if this commitment is breached.

- **Amount B under Pillar One.**[32] This consultation document outlines the main design elements of Amount B: the scope, the pricing methodology, and the current status of discussions concerning an appropriate implementation framework. The scope of Amount B defines the controlled transactions and sets out qualitative and quantitative criteria to help that determination. If the criteria are met and the taxpayer is therefore within the scope of Amount B, the Amount B pricing methodology would be applied to establish the arm's length price for the transaction, subject

---

30 O.E.C.D. (2022), *Public consultation document, Progress Report on the Administration and Tax Certainty Aspects of Pillar One.*

31 O.E.C.D. (2022), *Public consultation document, Pillar One – Amount A: Draft Multilateral Convention Provisions on Digital Services Taxes and other Relevant Similar Measures.*

32 O.E.C.D. (2022), *Public consultation document, Pillar One – Amount B.*

to potential exemptions which are currently under consideration.

- **Amount B under Pillar One.**[33] This consultation document outlines the Amount B under Pillar One scoping framework. The scope of Amount B focuses on a set of baseline wholesale distributors that can be reliably priced under a one-sided transfer pricing method by applying the pricing framework.[34] The Amount B scoping framework also permits the undertaking of *de minimis* retails sales, while excluding the distribution services and commodities from the scope.

In 2023, the O.E.C.D released the text of a new M.L.C. together with an Explanatory Statement and the document "The Understanding on the Application of Certainty for Amount A of Pillar One." The Explanatory Statement accompanies the M.L.C. and provides clarification on how each provision is intended to apply. "The Understanding on the Application of Certainty" contains further details on how aspects of the Amount A tax certainty framework will operate in practice.

On February 19, 2024, the O.E.C.D. published a final report on Amount B under Pillar One.[35] The final report on Amount B under Pillar One includes the following main points:

- **Considerations relating to the application of the simplified and streamlined approach.** This point explains

33 O.E.C.D. (2023), *Public consultation document, Pillar One – Amount B.*

34 In-scope distributors, for instance, should not own unique and valuable intangibles, nor should they assume certain economically significant risks.

35 O.E.C.D. (2024), *Pillar One - Amount B: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project.*

how jurisdictions will implement Amount B under Pillar One.

- **Transactions in scope**. This point defines transactions in scope of Amount B.

- **Application of the most appropriate method principle to in-scope transactions.** This point provides that qualifying transactions will be priced using the Transactional Net Margin Method ("T.N.M.M.") under the simplified and streamlined approach, unless an internal comparable uncontrolled price ("C.U.P.") can be identified.

- **Determining the return under the simplified and streamlined approach**. This point sets out how to price the returns due to in-scope distributors based on a standardized pricing matrix. It also includes a return on operating expenses crosscheck and a mechanism to adjust the returns for jurisdictions with low sovereign credit ratings and limited benchmarking data availability in the commercial database used by the O.E.C.D.

- **Documentation**. This point sets out the documentation requirements for businesses applying Amount B.

- **Transitional issues**. This point addresses scenarios in which business restructuring will cause a distributor to fall in or out of scope of Amount B.

- **Tax certainty and elimination of double taxation**. This point governs the relationship between counterparty jurisdictions, when one jurisdiction seeks to apply Amount B, to ensure tax certainty and the elimination of double taxation.

Further administrative guidance on Amount B under Pillar One was released by the O.E.C.D. on June 17, 2024. In February 2025, the O.E.C.D. released its consolidated report on Amount B under Pillar

One.[36] It incorporates the agreed material on Amount B that has been released by the O.E.C.D. from February 2024 through December 2024.

On January 13, 2025, the O.E.C.D. released a statement from the Co-Chairs of the Inclusive Framework on B.E.P.S. It provided an update on the progress made by the Inclusive Framework in developing a final package for Pillar One of the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy.

ii. <u>Pillar Two</u>

On November 8, 2019, the O.E.C.D. published a public consultation document[37] on Pillar Two for the development of a coordinated set of rules to address ongoing risks from structures that allow multinational enterprises to shift profit to jurisdictions where they are subject to no or very low taxation. On October 14, 2020, the O.E.C.D. published the Pillar Two Blueprint. Pillar Two foresees a global minimum tax regime with an agreed effective minimum tax rate for internationally operating businesses within its scope. Changes to domestic law and tax treaties will be required.

The effective minimum tax rate would both (i) identify "low tax jurisdictions" (*i.e.*, where a multinational enterprise's jurisdictional effective tax rate would be below the agreed minimum rate) and (ii) determine how much income must brought back into the tax net to raise the aggregate tax on income in that jurisdiction to the effective tax rate.

The proposal contains four rules for the case where income is not subject to tax at a minimum rate.

---

36 O.E.C.D. (2025), *Consolidated Report on Amount B: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*.

37 Public consultation document, Global Anti-Base Erosion Proposal ("GloBE") - Pillar Two, November 8, 2019 – December 2, 2019, page 9, paragraph 30.

a. **<u>Income Inclusion Rule</u>**

Income of a foreign branch or a controlled entity that is not subject to tax at a minimum rate should be taxed.

b. **<u>Undertaxed Payments Rule</u>**

A payment to a related party, which is not subject to tax at a minimum rate at the recipient's level, should not be tax deductible or should be subject to a withholding tax taxed at source.

c. **<u>Switch-over Rule in Tax Treaties</u>**

Where the profits attributable to a permanent establishment ("P.E.") or derived from immovable property which is not part of a P.E. are not subject to tax at a minimum rate, the residence jurisdiction should be permitted to switch from an exemption to a credit method.

d. **<u>Subject to Tax Rule</u>**

Where the payment is not subject to tax at a minimum rate, taxation at source should apply and the eligibility for treaty benefits may be restricted.

The relevant minimum tax rate is still to be determined.

The public was invited to submit written comments on the Blueprints by December 14, 2020, and a public consultation meeting was held virtually on January 14 and 15, 2021. The public consultation meeting focused on the key questions identified in the consultation document and raised in the written submissions that were received.

On June 5, 2021, the Finance Ministers and Central Bank Governors of the G7 countries released a communiqué supporting the efforts of G20/OECD Inclusive Framework on B.E.P.S. that address (i) tax challenges arising from globalization and digitalization of the economy and (ii) proposals to adopt a global minimum tax. They agreed on the importance of progressing both Pillars and reaching an agreement at the July meeting of G20 Finance Ministers and Central Bank Governors. With respect to Pillar Two, they committed to a global minimum tax rate of at least 15%, determined on a country-by-country basis.

e. 2021 Framework

The framework released in 2021 for Pillar Two consists of the following:

- Two interlocking domestic rules known as the global anti-base erosion rules ("GloBE") rules: (i) an income inclusion rule ("I.I.R.") which imposes a top-up tax on a parent entity in respect to the low-taxed income of a constituent entity and (ii) an undertaxed payment rule ("U.T.P.R.") which denies deductions or requires an equivalent adjustment to the extent the low-taxed income of a constituent entity is not subject to tax under an I.I.R.

- A treaty-based rule known as the subject to tax rule ("S.T.T.R.") that allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate. The S.T.T.R. will be creditable as a covered tax under the GloBE rules.

f. Model Rules for Global Minimum Tax

On December 1, 2021, the O.E.C.D. released model rules for Pillar Two[38] that would establish a global minimum tax.

Taxpayers that either have no foreign presence or that have less than €750 million in consolidated revenues are not inside the scope of the model rules. In addition, the Pillar Two model rules do not apply to government entities, international organizations, and non-profit organizations, nor do they apply to entities that meet the definition of a pension, investment, or real estate fund. These entities are

38 O.E.C.D. (2021), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS.*

excluded, but the M.N.E. group they control remains subject to the rules.

Taxpayers inside the scope of the rules must calculate their effective tax rate for each jurisdiction where they operate and pay top-up tax for the difference between their effective tax rate ("E.T.R.") per jurisdiction and the 15% minimum rate. Any resulting top-up tax is generally charged in the jurisdiction of the ultimate parent of the M.N.E. A *de minimis* exclusion applies where there is a relatively small amount of revenue and income in a jurisdiction.

The rules are drafted as model rules that provide a template that jurisdictions can translate into domestic law:

- Chapter 1 addresses questions of scope.

- Chapters 2-5 contain the key operative rules. An M.N.E. can apply the rules in the following steps:

    - Calculate the effective tax rate in each jurisdiction where the M.N.E. operates. This requires a calculation of the income and of the tax on that income. The income (or loss) is calculated based on financial accounts, with certain adjustments to reflect common permanent differences, remove certain dividends and equity gains, or expenses disallowed for tax purposes. There is an exclusion for international shipping income. The tax attributable to that income includes income taxes. The rules also address temporary differences which arise when income or loss is recognized in a different year for financial accounting and tax.

    - Calculate the top-up tax where there is low taxed income in a jurisdiction. The rate of tax owed is the difference between the 15% minimum rate and the E.T.R. in the jurisdiction. That top-up tax percentage is then applied to the GloBE income in the jurisdiction, after deducting a substance-based income exclusion (calculated as a percentage mark-up on tangible assets and payroll costs). If a jurisdiction has a domestic minimum tax that is consistent with the Pillar Two model rules, such domestic tax is credited against any Pillar Two minimum tax liability.

- Determine the liability for the top-up tax, i.e., which entity within the M.N.E. will be liable for the top-up tax on the low-taxed income arising in a jurisdiction. Under the I.I.R., the minimum tax is paid at the level of the parent entity, in proportion to its ownership interests in those entities that have low-taxed income. Generally, the I.I.R. is applied at the top, at the level of the ultimate parent entity, and works its way down the ownership chain. The U.T.P.R. is the backstop rule which requires an adjustment (such as a denial of a deduction) that increases the tax at the level of the subsidiary and which is sufficient to result in the group entities paying their share of the top-up tax remaining after the I.I.R.

- Chapter 6 deals with mergers and acquisitions.

- Chapter 7 provides special rules that apply to certain tax neutrality and existing distribution tax regimes.

- Chapter 8 provides an internationally coordinated approach to administering the rules. This includes a standardized information return, mechanisms to avoid duplicative reporting, and the scope to release coordinated guidance on the application of the rules in practice. Chapter 8 also provides for the possibility of safe harbors.

- Chapter 9 provides for rules on transition.

- Chapter 10 contains definitions.

The preamble to the Pillar Two model rules indicates that consideration will be given to the conditions under which the U.S. Global Intangible Low-Taxed Income ("G.I.L.T.I.") regime will co-exist with the GloBE rules to ensure a level playing field.

On March 14, 2022, the O.E.C.D. released detailed technical guidance on the Pillar Two model rules, including commentary on the global anti-base erosion model rules[39] and illustrative examples[40] and sought public comments. The commentary provides guidance on the interpretation and application of the GloBE rules to ensure a consistent and common interpretation. It also includes examples which illustrate the application of the rules for certain fact patterns.

On December 20, 2022, the O.E.C.D. released guidance on safe harbors and penalty relief[41] which includes the terms of a transitional country-by-country reporting safe harbor. It essentially removes the obligation for an M.N.E. to calculate the GloBE effective tax rate for its operations in lower-risk jurisdictions in its initial years, thereby providing some relief from GloBE compliance obligations as M.N.E.'s implement the rules. The document includes a framework for the development of permanent safe harbors as simplified income and tax calculations. It also provides a common understanding for a transitional penalty relief regime which requires careful consideration when applying penalties or sanctions where an M.N.E. has taken reasonable measures to ensure the correct application of the GloBE rules.

On February 2, 2023, the O.E.C.D. released administrative guidance for the Pillar Two GloBE rules.[42] The administrative guidance will ensure coordinated outcomes and greater certainty for businesses as they move to apply the global minimum corporate tax rules from the beginning of 2024. The administrative guidance will be

---

[39] O.E.C.D. (2022), *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two).*

[40] O.E.C.D. (2022), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples.*

[41] O.E.C.D. (2022), *Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two).*

[42] O.E.C.D. (2023), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two).*

incorporated into a revised version of the commentary that will be released later in 2023, replacing the original version of the commentary issued in March 2022. The Inclusive Framework will continue to release further administrative guidance on an ongoing basis to ensure that the GloBE rules continue to be implemented and applied in a coordinated manner.

On February 3, 2023, the O.E.C.D. sought and received public comments on the GloBE information return ("G.I.R."),[43] particularly on the data points that an M.N.E. group may need to collect in order to calculate the M.N.E. group's GloBE tax liability. The G.I.R. is intended to provide a framework for collecting information from M.N.E. groups that are within the scope of the GloBE rules on an annual basis, so that a tax administration is provided with the necessary information on the tax calculations made by the M.N.E. group so it can evaluate the correctness of a constituent entity's tax liability under the GloBE rules.

On February 3, 2023, the O.E.C.D. sought and received public comments on various mechanisms for achieving tax certainty under the GloBE rules.[44] These mechanisms would apply in advance of any action being taken by jurisdictions (*i.e.,* dispute prevention mechanisms such as reliance on commentary and administrative guidance developed by the Inclusive Framework and the conclusion of bilateral or multilateral advance pricing arrangements) as well as after action has been taken (*i.e.*, dispute resolution mechanisms through an existing legal instrument such as tax treaties or the Convention on Mutual Administrative Assistance in Tax Matters or through new mechanisms such as a new multilateral convention or under domestic law).

---

43 O.E.C.D. (2022), *Public consultation document, Pillar Two – GloBE Information Return.*

44 O.E.C.D. (2022), *Public consultation document, Pillar Two – Tax Certainty for the GloBE rules.*

On July 17, 2023, the O.E.C.D. released a report on the G.I.R.[45] The G.I.R. incorporates transitional simplified reporting requirements that allow M.N.E.'s to report their GloBE calculations at a jurisdictional level. The G.I.R. will be subject to coordinated filing and exchange mechanisms that allow M.N.E.'s to report their GloBE calculations on a single return, where the more detailed information is made available to implementing jurisdictions where a top-up tax liability may arise.

Additionally, on July 17, 2023, the O.E.C.D. released administrative guidance for the Pillar Two GloBE rules.[46] It includes guidance on currency conversion rules when performing GloBE calculations, on tax credits, and on the application of the Substance-based Income Exclusion ("S.B.I.E."). It also includes further guidance on the design of Qualified Domestic Minimum Top-up Taxes ("Q.D.M.T.T.") as well as two new safe harbors: (i) a permanent safe harbor for jurisdictions that introduce a Q.D.M.T.T., which will make compliance and administration easier for M.N.E.'s and tax administrations; and (ii) a transitional safe harbor, which provides the U.P.E. jurisdiction with relief from the application of the U.T.P.R. for fiscal years commencing on or before the end of 2025.

On December 18, 2023, and June 17, 2024, the O.E.C.D. released administrative guidance for the Pillar Two GloBE rules[47] which supplements the Commentary to the Global Anti-Base Erosion Model Rules. Its purpose is to clarify their application, including guidance on the application of the Transitional Country-by-Country Reporting Safe Harbor, a mechanism for allocating taxes arising under a Blended Controlled Foreign Corporation ("C.F.C.") Tax

---

45 O.E.C.D. (2023), *Tax Challenges Arising from the Digitalisation of the Economy – GloBE Information Return (Pillar Two).*

46 O.E.C.D. (2023), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two).*

47 O.E.C.D. (2023), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two).*

Regime when some of the jurisdictions in which the M.N.E. operates are eligible for the safe harbor, as well as guidance on the application of the recapture rule applicable to deferred tax liabilities ("D.T.L."), cross-border allocation of current and deferred taxes, allocation of profits and taxes in certain structures involving flow-through entities, and the treatment of securitization vehicles.

On April 25, 2024, the O.E.C.D. released its consolidated commentary for the Pillar Two GloBE rules.[48] The consolidated commentary incorporates guidance published by the O.E.C.D. before the end of December 2023.

On January 15, 2025, the O.E.C.D. released a series of documents on the application of the GloBE rules. These documents included, *inter alia*, the G.I.R.[49] and further administrative guidance covering the rules that should be relied upon to complete the G.I.R.[50]

---

48 O.E.C.D. (2024), *Tax Challenges Arising from the Digitalisation of the Economy – Consolidated Commentary to the Global Anti-Base Erosion Model Rules (2023): Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project.*

49 O.E.C.D. (2025), *Tax Challenges Arising from the Digitalisation of the Economy – GloBE Information Return (January 2025): Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project.*

50 O.E.C.D. (2025), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on Article 8.1.4 and 8.1.5 of the Global Anti-base Erosion Model Rules (January 2025), OECD/G20 Inclusive Framework on BEPS*. O.E.C.D. (2025), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on Article 9.1 of the Global Anti-base Erosion Model Rules (January 2025), OECD/G20 Inclusive Framework on BEPS.*

On May 9, 2025, the O.E.C.D. released its consolidated commentary to the GloBE model rules.[51] This consolidated commentary incorporates agreed upon administrative guidance released by the O.E.C.D. since March 2022 up until March 2025. Additionally, on May 9, 2025, the O.E.C.D. released illustrative examples regarding the application of the GloBE model rules to certain fact patterns. An earlier version was published by the O.E.C.D. on March 14, 2022.[52]

F. <u>B.E.P.S Action 2: Hybrid Mismatch</u>

i. <u>Focus</u>

Action Item 2 of the B.E.P.S. Action Plan focuses on hybrid mismatch arrangements frequently used by holding companies. The goal of such arrangements is to exploit differences in the taxation of financial instruments or entities between two or more countries. In other words, the differences in the tax treatment under two or more tax jurisdictions can produce a mismatch in tax outcomes that have the effect of reducing or eliminating the aggregate tax burden of the parties to the arrangement.

Three types of hybrid arrangements fall within the scope of Action Item 2:

- Hybrid financial instruments, *e.g.,* instruments that are treated as equity in one jurisdiction and as debt in another

- Hybrid transfers*, e.g.,* transfers that are treated as to their form in one jurisdiction and as to their economic substance in another

---

51 O.E.C.D. (2025), *Tax Challenges Arising from the Digitalisation of the Economy – Consolidated Commentary to the Global Anti-Base Erosion Model Rules (2025): Inclusive Framework on BEPS, OECD (20 Base Erosion and Profit Shifting Project.*

52 O.E.C.D. (2025), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two).*

- Hybrid entities, *e.g.,* entities that are treated as taxable in one jurisdiction and as transparent in another

In the Final Recommendations, the O.E.C.D. confirmed the guidelines set out in its intermediary report presented in 2014.

As a result, two basic mismatched tax outcomes were distinguished:

- An outcome involving a deduction in one country with no inclusion of income in another country ("D./N.I.")

- A double deduction outcome in which one payment is deductible in two or more jurisdictions while the income is taxed only once or not at all ("D.D.")

Another version of the D./N.I. outcome was addressed under which a stranger to an intercompany transaction is imported into the arrangement to obtain a deduction that offsets unrelated income. This is the so-called "imported mismatch arrangement" and involves the use of a plain vanilla financial instrument that benefits the unrelated party.

Further, it should be noted that the O.E.C.D. issued additions to its Final Recommendations. The additions address hybrid mismatches[53] resulting from differences in the way payments between a permanent establishment and its head office are characterized under local tax law. The aim of these specific recommendations is to align the treatment of such structures with the treatment of classic hybrid mismatch arrangements.

ii. <u>Illustrative Fact Patterns</u>

For the purpose of this chapter and due to the broad scope of Action Item 2, only a few examples of hybrid mismatch arrangements will be presented. Typical hybrid mismatches that lead to a D./N.I.

---

53 O.E.C.D. (2017), *Neutralising the Effects of Branch Mismatch Arrangements, Action 2: Inclusive Framework on BEPS*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D. Publishing, Paris.

outcome are illustrated by structures involving hybrid financial instruments. The instrument is treated as debt in the issuer's country of residence and as equity in the holder's country. The issuer of the instrument treats its payment as deductible interest, and the payee or holder treats the payment as a tax-exempt dividend.

Another example of hybrid mismatch can be found in arrangements with payments to reverse hybrid entities. Such entities are treated as tax transparent in one jurisdiction and as opaque in another. By way of illustration, a company that is resident in Country A owns all the issued and outstanding shares in a subsidiary resident in Country B. The subsidiary was formed under the laws of Country B. The subsidiary is tax transparent under Country B's laws but is regarded as a separate taxable entity under the laws of Country A. Company C, residing in Country C, borrows money from the subsidiary and makes an interest payment under the loan. The payment is deductible under Country C's tax law but is not included in income under the laws of either Country A or B. Each of those countries treats the income as being derived by a resident of the other jurisdiction.[54]

A third example of a hybrid mismatch transaction involves the payment made by a hybrid entity. In this scenario, the payer is usually tax transparent under the law of the jurisdiction of its parent or investor, but not in its own jurisdiction. By way of illustration, Company A, a resident in Country A, owns all the issued and outstanding shares in Company B, a resident in Country B. Under the laws of Country A, Company B is viewed to be a branch of Company A. The tax transparent subsidiary borrows from Company A and pays interest on the loan. The loan is ignored under the laws of Company A. Because Company B is the parent of a consolidated group in Country B, the interest paid to Company A gives rise to a deduction that reduces the income of the Company B group. Nonetheless, there is neither income nor tax in Country A because

54 O.E.C.D. (2015), *Neutralising the Effects of Hybrid Mismatch Arrangements*, *Action 2 – 2015 Final Report*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D. Publishing, Paris.

the loan and the interest are treated as an internal transaction that is disregarded for the purposes of Country A law.

iii. Recommended Action

In order to combat each of these hybrid mismatch outcomes, the report provides two sets of recommendations. One provides recommendations for domestic tax and the other provides recommendations for changes to the O.E.C.D. Model Tax Convention.

With respect to the domestic rules, the report recommends a denial of deductions in the country of the payer of the interest as the primary rule, and if the primary rule is not adopted in the relevant country, the imposition of tax in the country of the recipient as a secondary rule. In practice, when two jurisdictions are involved in a hybrid mismatch arrangement, the primary rule should determine which of the two jurisdictions ensures that tax is collected. In the event the jurisdiction of the payer has not introduced relevant hybrid mismatch legislation, the jurisdiction of the recipient should be entitled to rely on the secondary rule to neutralize the mismatch. Additionally, the report recommends improving controlled foreign corporation ("C.F.C.") rules and the limitation of the tax transparency of reverse hybrids. In addition, the report advocates the implementation of rules that will adjust the tax outcome in one jurisdiction and align them with tax consequences in another.

As to treaty language, the report sets out a range of recommendations for changes to the O.E.C.D. Model Tax Convention to ensure that hybrid instruments and entities, as well as dual resident entities, are not used unduly to obtain the benefits of treaties. The latest edition of the O.E.C.D. Model Tax Convention, of November 2017, reflects the additional hybrid mismatches recommendations under Action Item 2.

G. B.E.P.S. Action 3: Drafting Effective Controlled Foreign Company Rules[55]

i. Focus

The objective of the C.F.C. rules is to avoid or neutralize cases where groups or individuals create affiliates that may be established wholly or partly for tax reasons in other jurisdictions in order to be repositories of diverted income. In other words, the aim of the C.F.C. rules are to avoid the shift of income by ensuring that profits remain in the taxable base of the controlling entity in relation to the C.F.C.

In this context, and on a consolidated basis, the effect of C.F.C. rules are not to increase the taxable base of a group of entities located in several jurisdictions but to ensure its substantial allocation between each group member by reallocating all or part of the taxable base between the parent and subsidiary entities.

C.F.C. rules have been implemented in domestic jurisdictions since 1962 and continue to be adopted by an increasing number of countries since then. However, not all countries have adopted such measures in national legislation, and a gap in compliance exists.

In the general framework of the B.E.P.S. Project, Action Item 3 focuses on recommendations that aim to develop and design new C.F.C. rules that are efficient in a B.E.P.S. context. Such recommendations are focused on six topics which can be divided into three parts:

- Definitions of C.F.C. rules, exemptions, and threshold requirements

- Definitions of C.F.C. income and rules to compute and attribute that income to others

---

55 O.E.C.D. (2015), *Designing Effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D. Publishing, Paris.

- Rules to prevent or eliminate double taxation occurring within the context of the C.F.C. rules

ii. Recommended Actions

In October 2015, a final report on Action Item 3 was published. As mentioned above, the aim of this report was to provide national legislators and governments with recommendations tailored to avoid B.E.P.S. situations on a C.F.C. context.

Firstly, the O.E.C.D. provides recommendations for developing rules that define what should be deemed a C.F.C. In order to define a C.F.C., the national legislator should (i) consider whether or not a foreign entity could be considered a C.F.C. by determining what type of entities should fall within the scope of the national C.F.C. rules (*i.e.,* corporate entities, transparent entities, and permanent establishments) and (ii) determine whether the parent company located in the legislator's country has sufficient influence or control over the foreign entity by establishing legal and economic controlling tests, or if appropriate, the adoption of a *de facto* test or a more substantial anti-avoidance approach if considered necessary.

The O.E.C.D. recommends that C.F.C. exemptions and threshold requirements be permitted in order to (i) limit the application of C.F.C. rules to situations that present a high risk of B.E.P.S. situations and (ii) avoid a disproportionate administrative burden for taxpayers and national administrations. These recommendations should be reflected in an exemption in the jurisdiction of the controlling shareholder based on the "effective tax rate" of the C.F.C., so that the C.F.C. inclusion rule would not apply when the C.F.C. has an effective rate that is similar to the rate applied in the parent jurisdiction.

The final report on Action Item 3 then focuses on the definition, computation, and allocation of C.F.C. income.

Possible approaches to identifying C.F.C. income that should be attributed to the controlling shareholders include (i) a categorical analysis of the income, (ii) determination of the part of the profit that could be considered to exceed a "normal return" generated by

C.F.C.'s located in low tax jurisdictions, and (iii) a case-by-case analysis based on the transactions and entities involved.

Computation of such income should be made under the rules of the parent jurisdiction. These rules should allow for a full offset of C.F.C. losses in order to maintain a comparable treatment between C.F.C. profits and C.F.C. losses that are allocated in the jurisdiction of the controlling entity.

The attribution of C.F.C. income should be consistent with the recommendations dealing with the definition of a C.F.C. and should take into account the percentage and period of ownership within a particular year. C.F.C. income should be treated in accordance with the applicable rules of the parent jurisdiction.

Finally, in acknowledging its historic role, the O.E.C.D. recommends Action Item 3 rules that prevent or eliminate double taxation occurring due to allocations of income under C.F.C. rules.

Double taxation can appear as a result of C.F.C. rules when C.F.C. income is subject to corporation income tax in two or more jurisdictions, or if the same C.F.C. income is targeted by more than one jurisdiction. In these two cases, the O.E.C.D. recommends that a tax credit should be allowed in the parent jurisdiction. For the avoidance of doubt, this tax credit amount should correspond to all taxes due from the C.F.C. on income that has not qualified for other tax relief but should not exceed the tax amount due on the same income in the parent jurisdiction.

Double taxation can also exist if a C.F.C. actually distributes a dividend from a pool of income that has already been apportioned to the parent company and taxed in its country of residence. In that case, the O.E.C.D. recommends the allowance of an exemption for the actual dividend and a basis increase to reduce or eliminate the gain.

H. B.E.P.S. Action 4: Interest Deductions and Other Financial Payments

i. Focus

Action Item 4 focuses on the need to address B.E.P.S. using deductible payments, such as interest, that can give rise to double nontaxation in inbound and outbound investment scenarios.[56]

The fact patterns deemed to be abusive are those that allow the use of the following tax-saving devices:

- Intragroup loans to generate deductible expenses in a high-tax jurisdiction and taxable interest income in low-tax jurisdictions
- Interest deductions on loans that finance assets that produce exempt income or income recognized on a deferred basis
- Hybrid mismatches between jurisdictions generating interest deductions but no taxation of income
- A disproportionate level of third-party debt incurred by companies located in high-tax jurisdictions compared to the group overall debt

ii. Recommended Action

Action Item 4 analyzes best practices and recommends an approach, with alternative restricted options to take into consideration local economic circumstances, to address these occurrences of base erosion and profit shifting.

The recommended approach consists of a limitation of the allowed interest deduction with reference to a fixed ratio. Under this

---

56 O.E.C.D. (2015), *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2015 Final Report*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D. Publishing, Paris.

scenario, an entity would be able to deduct interest expense up to a specified portion of its earnings before interest, taxes, depreciation, and amortization. This approach is intended to link the amount of deductible net interest to taxable economic activity. Each country's government would thus determine a benchmark fixed ratio which will apply irrespective of the actual leverage of an entity or its group. Interest paid by the entity to third or related parties will be deductible up to this fixed ratio, but any interest above this ratio will be disallowed.

In order to address B.E.P.S. risks, Action Item 4 recommends that countries establish their benchmark fixed ratio in a corridor between 10% and 30%, depending on their legal framework and economic circumstances.

Nevertheless, recognizing that the establishment of a fixed ratio does not cover possible variations in group leverage based on industry practice, the fixed ratio rule should be combined with a group ratio rule. In this scenario, interest above the fixed ratio may still be deductible based on the ratio of the worldwide group (*i.e.*, net third-party interest expense or group E.B.I.T.D.A.). This combination may be included in a separate rule or as part of the general overall provision.

Other suggestions are also proposed in Action Item 4 to tackle the adverse effects of a rigid application of the benchmark ratio approach, such as potential volatility in earnings that impact the ability to deduct interest expense in a particular period. Where that occurs, several safe harbors may apply, such as determining the group ratio rule on an equity-to-total assets ratio ("Equity Escape Rule"), or by using an average E.B.I.D.T.A over several years, or by carrying interest expense to earlier or later periods.

Therefore, under Action Item 4, the O.E.C.D. remains flexible on the implementation of the recommended approach and additionally offers the opportunity for each country to implement more specific rules in addition to this general approach in order to target any behavior leading to B.E.P.S. Further work on the recommended approach was provided at the end of 2016, including guidance on group ratio rules and specific rules to address the issues raised by the insurance and banking sectors.

I. B.E.P.S. Action 5: Harmful Tax Practice

i. Focus

Another B.E.P.S. Action substantially affecting holding companies is the portion of Action Item 5 that is intended to "counter harmful tax practices more effectively, taking into account transparency and substance." Previous O.E.C.D. publications, such as the O.E.C.D.'s 1998 report *Harmful Tax Competition: An Emerging Global Issue.*[57] show that the topic has been discussed for many years among the different stakeholders. Action Item 5 proposes to reorganize the existing material gathered by the Forum on Harmful Tax Practices (the "Forum") with regard to aggressive benefits granted to cross-border transactions by various countries in their respective domestic tax laws.

ii. Illustrative Fact Patterns

A typical argument and organization used by an M.N.E. when investing in intellectual property ("I.P.") through a jurisdiction offering an attractive I.P. regime can be described as follows:

- A multinational group holding I.P. rights has its seat located in a jurisdiction that has no favorable tax regime for I.P. holders.
- No tax incentives are available to reduce income from license fees and royalties generated by the exploitation of these I.P. rights.
- The M.N.E. will be taxable on the income arising from the exploitation of its I.P. at ordinary corporation income tax rates.

To address the situation, the M.N.E. interposes a company ("I.P. Co") located in a jurisdiction that has laws providing a more favorable I.P. regime ("the other jurisdiction"). The I.P. rights are

57 O.E.C.D. (1998), *Harmful Tax Competition: An Emerging Global Issue*, O.E.C.D. Publishing, Paris.

held by I.P. Co, and it receives royalties from other group members for the use of the I.P. These royalties are fully deductible by group members utilizing the I.P. but are fully or partially exempt when I.P. Co computes its tax under the laws of the other jurisdiction. The group uses the accumulated funds within I.P. Co through intercompany loans that give rise to interest expense that is fully deductible by group members without being subject to withholding tax.

iii. Recommended Action

In October 2015, a final report on Action Item 5 was published.[58] In broad terms, Action Item 5 is aimed at tackling any corporate arrangements benefiting from disproportionate tax advantages in a given jurisdiction. It requires that corporate substance and activity should be in line with taxation and that tax transparency should be enhanced through the exchange of rulings related to low tax schemes.

The work already performed by the Forum with respect to the substance requirements focused principally on I.P. regimes. Although other advantageous tax regimes have been scrutinized, the I.P. regime will be the only regime addressed in this chapter.

As mentioned in the report, the nexus approach is the approach selected to impose a substantial activity requirement for preferential I.P. regimes. The nexus approach enables a taxpayer to benefit from an I.P. regime if it has itself performed the research and development that gives rise to the I.P. income. The nexus approach recommends that M.N.E.'s adjust their operational substance activity so that the tax benefit from the regime is closely tied to the economic reality of operations. In other words, income derived from eligible I.P. rights should derive benefits of a favorable tax treatment only in proportion to the research and development expenditures incurred

58 O.E.C.D. (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D. Publishing, Paris.

by the taxpayer in relation to the I.P. rights, when compared to global expenditures related to the I.P. rights.

As part of the nexus approach, it has been agreed that countries offering I.P. regimes are required to implement changes ensuring that no harmful tax incentives are granted after June 30, 2016. Companies currently enjoying I.P. regimes that would no longer be eligible under the new international standards should benefit from a five-year grandfathering period.

In the above example, the direct consequence of Action Item 5 will be that I.P. Co will be taxed at full corporate rates in the other jurisdiction on its royalty and license fee income after completion of the five-year grandfathering period, unless it fully staffs the company with personnel performing research and development activities. The other jurisdiction may provide tax and other incentives that are not considered harmful under Action Item 5. While the scope of acceptable incentives is not yet known, jurisdictions that have already developed a reduced-tax regime for I.P. should be able to develop a new regime that meets the standards of Action Item 5.

The second milestone of Action Item 5 is the improvement of transparency, including the mandatory exchange of rulings regarding low-tax schemes. With regard to transparency, the work of the Forum follows a three-step approach. The first step aims to develop a framework for compulsory spontaneous information exchange on rulings, while the second step focuses on the application of this framework, including a review of ruling regimes in force in O.E.C.D. and associated countries. As a third part, the Forum sets guidelines for countries still using such ruling procedures.

The scope of the automatic exchange of ruling procedure covers six categories of rulings, *viz.,* (i) rulings relating to preferential regimes, (ii) unilateral advance pricing rulings or other cross-border unilateral rulings in respect of transfer pricing, (iii) cross-border rulings providing for a downward adjustment of taxable profits, (iv) permanent establishment rulings, (v) related-party conduit rulings, and (vi) any other type of ruling which could give rise to B.E.P.S. concerns.[59]

Once information related to the above-listed rulings has been received by the taxpayer's country, this should be further communicated to the countries of residence of all related parties involved in the ruling, and to the country of residence of the ultimate parent company.

Apart from establishing an exhaustive list of rulings falling under the scope of the exchange, the report specifically sets a timeframe and distinguishes past rulings from future rulings. It clearly states that any past rulings that have been issued, modified, or renewed on or after January 1, 2010, and which are still valid on January 1, 2014, will have to be exchanged before the end of 2016. For the future rulings, *i.e.,* rulings issued on or after April 1, 2016, the exchange should take place within three months of the ruling issuance and should be organized between the country granting the ruling, the countries of the immediate parent, the ultimate parent, and the countries of residence of affected related parties.

The information to be exchanged has been listed in a template available as an Annex to the report. This standardized approach will facilitate the exchange of useful information and lower administration costs.

On July 11, 2016, the O.E.C.D. released its standardized electronic file format for the exchange on tax rulings ("E.T.R.") between jurisdictions – the E.T.R. XML Schema – as well as the related guidance documentation ("User Guide") for tax administrations, which were updated in September 2017. The User Guide provides further details on the information that must be reported. It also contains instructions on how to modify data elements within the file.

As mentioned in the report, the E.U. has been working on measures in the field of compulsory exchange of rulings. On December 8, 2015, Council Directive 2015/2376 provided for the automatic exchange of information regarding cross-border tax rulings and

---

59 *Id.*, p. 46.

advance pricing arrangements with effect from January 1, 2017. The two initiatives move in the same direction in parallel. Such transparency initiatives raise issues that may cause collateral damage if not addressed. One area of concern is the confidentiality of the information received by a country. A second area is the comparability of the information sent by one country with the information received from another. The tax administrations in some countries may take more time to develop a system that provides the desired level of information.

In a third and final step, the report provides a list of best practices to use in countries where a ruling regime is available. These guidelines include developments on a detailed process for granting rulings, indications in relation to the terms of the ruling, the subsequent audit or checking procedure to be put in place, and a final statement on the publication and exchange of information.

On February 1, 2017, the O.E.C.D. released the *Terms of Reference and Methodology for Peer Reviews*[60] addressing the exchange of information on tax rulings. The peer review and the monitoring process will be conducted by the Forum to ensure the effective implementation of the agreed-upon standards.

All jurisdictions that have committed to implementing the minimum standards of Action Item 5 are subject to a peer review of their implementation.

In January 2019, the O.E.C.D. released the report "Harmful Tax Practices – 2018 Progress Report on Preferential Regimes,"[61] which includes the results of a review of preferential tax regimes since the

---

60 O.E.C.D. (2017), *B.E.P.S. Action 5 on Harmful Tax Practices – Terms of Reference and Methodology for the Conduct of the Peer Reviews of the Action 5 Transparency Framework*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D., Paris.

61 O.E.C.D. (2019), *Harmful Tax Practices – 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D. Publishing, Paris.

start of the B.E.P.S. Project. This review was undertaken by the Forum on Harmful Tax Practices ("F.H.T.P.") in accordance with the B.E.P.S. Action 5 minimum standards. In total, 255 preferential tax regimes were reviewed to ensure compliance with the nexus approach. More than half of these have been amended or abolished. The others were either already compliant with the Action 5 standard or in the process of being reviewed or reformed. As part of ongoing work to revise the existing F.H.T.P. criteria, a new standard, which imposes substantial activities requirements on low or no-tax jurisdictions, was adopted in 2018. In October 2019, the Inclusive Framework released guidance on the framework for the spontaneous exchange of information collected by low or no-tax jurisdictions.

In January 2023, the Inclusive Framework released updated conclusions on the review of preferential tax regimes. Since the inception of the B.E.P.S. Project, the F.H.T.P. has reviewed 319 regimes.

On December 14, 2022, the O.E.C.D. released the 2021 peer review assessments of 131 jurisdictions regarding the spontaneous exchange of information on tax rulings. Over 23,000 tax rulings were identified and almost 50,000 exchanges between jurisdictions took place. Out of the 131 reviewed jurisdictions, 73 jurisdictions did not receive any recommendations, as they have met all the terms of reference. A further 19 jurisdictions received only one recommendation. This is the second review that took place under the renewed peer review process issued on February 22, 2021.

J. B.E.P.S. Action 6: Prevent Treaty Abuse

i. Focus

As mentioned in the introduction to this article, holding companies may be used as a tool for tax planning and treaty shopping. Treaty shopping normally involves a resident of a country gaining access to a tax treaty between two other states either through a conduit company or by any other arrangements in circumstances where the resident would not otherwise have been able to claim a comparable benefit to reduce its overall taxable burden.

To combat this practice, the O.E.C.D. has amended its commentaries related to the Model Tax Convention regarding beneficial ownership requirements in connection to Articles 10 (Dividends), 11 (Interest), and 12 (Royalties). Nevertheless, the efficiency of these measures is now being questioned by Action Item 6 of the B.E.P.S. Project.

The B.E.P.S. Action Plan has identified treaty abuse, and particularly treaty shopping, as one of the most important sources of base erosion and profit shifting. The Final Recommendations on Action Item 6[62] make a distinction between two types of treaty abuse:

- Abuse of the tax treaty itself
- Abuse of domestic tax law by using treaty benefits

ii. Recommended Action

In order to address treaty shopping arrangements, the O.E.C.D. recommends a treaty-based solution and the following amendments to the Model Tax Convention:

- The inclusion in the title and preamble of tax treaties of a clear statement that the contracting states, when entering into a treaty, intend to avoid creating opportunities for nontaxation or reduced taxation.
- The inclusion in tax treaties of a specific anti-abuse rule based on the limitation on benefits ("L.O.B.") provisions, as are already provided in treaties concluded by the United States and a few other countries.

---

62 O.E.C.D. (2015), *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D. Publishing, Paris.

- The addition to tax treaties of a more general anti-abuse rule ("G.A.A.R") based on the principal purpose test ("P.P.T.") to address other forms of treaty abuse.[63]

The L.O.B. clause provides a relatively objective basis for establishing a nexus between treaty benefits and entities having a relationship with the resident country. However, some commentators pointed out that non-collective investment vehicle ("non-C.I.V.") funds[64] would not qualify under the L.O.B. rules, as they do not meet any of the proposed requirements.[65] Regarding their particular activity, discussions are taking place to determine whether these non-C.I.V. funds should qualify *per se* under the L.O.B. provisions or whether a genuine diversity-of-ownership test should apply under which each investor must meet an L.O.B. test separately.[66]

Since the L.O.B. clause might not catch all "conduit arrangements," a G.A.A.R provision should be included in future tax treaties to deny benefits "if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the

63 *Id.*

64 The term "C.I.V." appears to be limited to funds that are widely held, hold a diversified portfolio of securities, and are subject to investor protection regulation in the country in which they are established. In this context, non-C.I.V. funds should refer, *inter alia*, to alternative funds, pension funds, and sovereign wealth funds.

65 O.E.C.D. (2015), *Revised Discussion Draft, B.E.P.S. Action 6: Prevent Treaty Abuse*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D. Publishing, Paris.

66 O.E.C.D. (2016), *Public Discussion Draft, Treaty Entitlement of Non-C.I.V. Funds*, O.E.C.D./G-20 B.E.P.S. Project, O.E.C.D. Publishing.

principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit."[67]

As pointed out by commentators, the scope of G.A.A.R. could lead to legal uncertainties. In particular, holding and financing activities, even though constituting genuine business activities, may fall within this scope.

In addition, the wording of G.A.A.R. provisions raise issues with regard to E.U. law since it targets arrangements where "one of the principal purposes" is the intention to obtain the treaty benefits. The proposed P.P.T. rule may therefore be considered too extensive with respect to E.U. fundamental freedoms. The European Court of Justice has stated:

> [A] national measure restricting freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned.[68]

Thus, the report recognizes that flexibility may be required in the adoption of the suggested rules in relation to domestic anti-abuse regimes, constitutional issues, policy choices, and E.U. laws.[69]

As a minimum standard, countries are expected to include in tax treaties an express statement regarding the common intention to avoid creating opportunities for nontaxation or reduced taxation and to carry out that intention by (i) a combined L.O.B. rule with a P.P.T.

---

67 O.E.C.D., *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances.*

68 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case C-196/04, [2006] E.C.R. I-07995.

69 O.E.C.D., *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances,* p. 19, ¶21-22.

rule, (ii) the P.P.T rule, or (iii) the L.O.B. rule complemented by an anti-conduit arrangement rule.

The second type of abuse analyzed by Action Item 6 addresses situations where treaties prevent the application of specific domestic laws targeting abuses such as domestic G.A.A.R., thin capitalization, C.F.C. diversions of income, exit or departure taxes, and similar provisions. Aside from the inclusion of new commentaries in the O.E.C.D Model Tax Convention on these issues and in relation to the new P.P.T. rule aimed at maintaining the application of domestic anti-avoidance rules, Action Item 6 introduces in tax treaties a "saving clause" that confirms the Contracting States' right to tax their residents according to their domestic law, notwithstanding the provisions of the tax treaty. As the O.E.C.D. pointed out, such a provision could clearly lead to double taxation and thus, would require further work in the first part of 2016. Additionally, Action Item 6 addresses the issue of exit or departure taxes by confirming that clarification will be made to the commentary on the O.E.C.D. Model Tax Convention to maintain domestic application.

The multilateral instrument mandated by the O.E.C.D. members and G-20 is intended to implement the various anti-abuse rules included in Action Item 6.

The latest edition of the O.E.C.D. Model Tax Convention of November 2017 notably reflects the treaty-related recommendations under Action Item 6 of the B.E.P.S. Action Plan.

Since 2019, the O.E.C.D. has released peer review reports assessing the implementation of the Action 6 minimum standards annually.

In April 2021, the O.E.C.D. released the Revised Peer Review Documents including the Terms of Reference which set out the criteria for assessing the implementation of the minimum standard and the methodology which sets out the procedural mechanism by which the review will be conducted.

The peer review published on March 21, 2023, reveals that a large majority of Inclusive Framework members have modified, or are in the process of modifying, their treaty networks and that the M.L.I., which implements the treaty related B.E.P.S. measures, appears to be the preferred tool.

In January 2024, the O.E.C.D. released an updated version of the revised peer review documents which it originally released in 2021. It includes the terms of reference which set out the criteria for assessing the implementation of the minimum standard and the methodology which sets out the procedural mechanism by which the review will be conducted.

The latest peer review, published by the O.E.C.D. in March 2024, indicates that a large majority of the Inclusive Framework Members have modified, or are in the process of modifying, their treaty network to implement the minimum standard and other B.E.P.S. treaty-related measures.

K. <u>B.E.P.S. Action 15: Multilateral Instrument</u>

i. <u>Scope of the M.L.I.</u>

The M.L.I. implements a number of treaty-related measures recommended by the B.E.P.S. Action Plan.

The purpose of the M.L.I. is to implement the treaty-related minimum standards in a swift, coordinated, and consistent manner across the network of existing tax treaties without the need to bilaterally renegotiate each tax treaty. The M.L.I. is flexible enough to accommodate the positions of different countries and jurisdictions through the use of certain opt-in or opt-out mechanisms that are mandatory unless the relevant treaty already meets the minimum standards. It also includes provisions that go beyond the minimum standards, which may or may not be implemented at the option of the countries involved.

The M.L.I. directly amends all bilateral tax treaties that are in force between the signatory states. Each state must, however, provide the O.E.C.D., which is the Depositary for the M.L.I., with a list of the treaties to be covered ("Covered Treaties"), as well as the options that were implemented by the relevant state in the Covered Treaties.

The treaty-related measures of the B.E.P.S. Project include Action Item 2 on hybrid mismatches, Action Item 6 on treaty abuse, Action Item 7 on the artificial avoidance of the permanent establishment status, and Action Item 14 on dispute resolution and arbitration. Only Action Item 6, the P.P.T., and the dispute resolution mechanism under the mutual agreement procedures are required by the minimum standards.

ii. <u>Main Provisions of the M.L.I.</u>

a. <u>Hybrid Mismatches</u>

Article 3 of the M.L.I. provides for certain rules regarding so-called hybrid mismatches, in particular in regard to (i) tax transparent entities, (ii) dual residence, and (iii) the elimination of double taxation. These provisions are optional and hence the implementation thereof depends on each of the Contracting States.

1) <u>Transparent Entities</u>

Article 3.1 of the M.L.I. introduces a new rule for the application of a tax treaty to the income derived from tax transparent entities. Accordingly, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State is considered income of a resident of a Contracting State only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

As an example, assume that State A and State B have implemented Article 3.1 of the M.L.I. A Borrower resident in State A pays interest to a wholly or partly tax transparent Lender established in State B. State A considers the Lender established in State B to be a company and that State B will tax the Lender on the interest that it receives from the Borrower in State A. State B, however, treats the Lender as a partnership, and the two partners who share the partnership's income equally are each taxed on half the income. One of the partners is resident in State B and the other is resident in a State that has not concluded a tax treaty with either State A or State B. According to Article 3.1 of the M.L.I., half of the interest is considered income of a resident of State B.

2) Dual Resident Entities

In cases where a party other than an individual is a resident of both Contracting States, Article 4 of the M.L.I. provides that the competent authorities must determine the residence of the person by mutual agreement using a tie-breaker that takes into account the place of effective management, the place of incorporation, and any other relevant factors. In the event that no mutual agreement can be reached, the party is not entitled to any tax relief or exemption provided by the tax treaty, except to the extent that and in such a manner as is agreed upon by the competent authorities.

3) Elimination of Double Taxation

Contracting States may choose to implement one of the three optional methods for the elimination of double taxation. The alternatives are outlined in Article 5 of the M.L.I.:

- Under Option A, provisions of a Covered Treaty that would otherwise exempt income derived by, or capital owned by, a resident of a Contracting State from tax in the other Contracting State do not apply if the other Contracting State also applies the treaty to exempt such income or capital from tax or to limit the rate of taxation thereof. In the latter case, a tax credit should be granted by the state of residence.

- Under Option B, provisions of a Covered Treaty that exempt dividend income derived by a resident of a Contracting State from tax in the other Contracting State do not apply if such income gives rise to a deduction for the payor resident in the other Contracting State. In this case, a tax credit should be granted for the income tax paid in the source state.

- Under Option C, each Contracting State exclusively uses the credit method to eliminate double taxation for its residents.

b. Treaty Abuse

1) Minimum Standards

Article 6 of the M.L.I. requires Covered Treaties to introduce the minimum standard for protection against tax treaty abuse as an express statement using the following text as part of the preamble to the treaty:

> Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)

It should be noted that the inclusion of this language is itself a minimum standard and hence mandatory. This provision further allows a Contracting State to apply its domestic general anti-abuse rules to a given transaction.

2) P.P.T. and L.O.B.

The provisions based on Action Item 6 include three alternatives for addressing situations of treaty abuse:

- The first is a P.P.T.
- The second is a P.P.T. and an L.O.B. provision.
- The third is a detailed L.O.B. provision supplemented by a mechanism to deal with conduit arrangements not already addressed in the treaty.

Under the P.P.T., a benefit of a Covered Treaty will be denied if, considering all relevant facts and circumstances, it is reasonable to conclude that obtaining the benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is in accordance with the object and purpose of the relevant treaty provisions.

The P.P.T. may be supplemented by an L.O.B. clause. The M.L.I. does not provide for a standard *detailed* L.O.B. as outlined in the Final Report on Action Item 6, but merely states that a detailed L.O.B. clause may be agreed on bilaterally. As a result, only a *simplified* L.O.B. clause is included in the M.L.I., which provides that the benefits of a Covered Treaty are only accessible to a "qualified person" unless the person is engaged in the active conduct of a business. A qualified person must fulfill certain requirements proving a sufficiently strong link with the claimed state of residence in order to receive benefits under the Covered Treaty.

The detailed L.O.B. clause described in the Final Report of Action Item 6 also addressed C.I.V. funds, but since these provisions were not introduced into the M.L.I., uncertainty regarding their treatment persists. Similarly, the application of the P.P.T. or the L.O.B. clause in respect to non-C.I.V. funds has not been addressed by the M.L.I. or the explanatory statements. However, a consultation document tackling this issue was released in early 2017 by the O.E.C.D., confirming that the O.E.C.D. is continuing to examine issues relating to non-C.I.V. funds and plans to ensure that the new treaty provisions included in the B.E.P.S. Report on Action Item 6 adequately address the treaty entitlement of these funds. Accordingly, a separate report is expected to be released by the O.E.C.D. in the future.

3) Dividend Transfer Restriction

The M.L.I.'s dividend transfer restriction is based on Article 10(2) of the O.E.C.D. Model Tax Convention of the Action Item 6 Report. It introduces a minimum shareholding period of 365 days (including the day of the payment of the dividends) to a Covered Treaty's existing provisions without changing the substantive allocation of taxation rights between the Contracting States.

4) Capital Gains Derived Indirectly from Real Estate

The M.L.I. bases its treatment of capital gains derived indirectly from real estate on Article 13(4) of the O.E.C.D. Model Tax Convention as revised by the Action Item 6 Report.

According to Article 13(4) of the O.E.C.D. Model Tax Convention, gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other state. In order to avoid situations where assets are contributed to an entity shortly before a sale of its shares or comparable interests in order to dilute the proportion of the entity's value that is derived from immovable property, the M.L.I. (i) introduces a testing period for determining whether the value threshold is met and (ii) expands the scope of covered interests to include interests comparable to shares, such as interests in a partnership or trust. Accordingly, the relevant provisions allowing the source state to tax such capital gains may continue to apply if the relevant value threshold is met at any time during the 365 days preceding the alienation, and may apply not only to shares but also to comparable interests, such as interests in a partnership or trust.

5) Anti-Abuse Rule for Exempt or Low-Taxed Permanent Establishments

Article 10 of the M.L.I. addresses cases where an enterprise in one Contracting State derives income from the other Contracting State, and the first Contracting State treats the income as exempt income attributable to a permanent establishment of the enterprise situated in a third jurisdiction.

6) Saving Clause

The M.L.I. provides for a "saving clause" that preserves the right of a Contracting State to tax its own residents. Therefore, a tax treaty will not affect the taxation by a Contracting State of its own residents, except with respect to the benefits granted under the provisions of the tax treaty, such as the double tax relief article.

c. Avoidance of Permanent Establishment Status

In accordance with the objective of Action Item 7, the M.L.I. aims to amend existing tax treaties to counter the artificial avoidance of permanent establishment status through various methods, described below.

1) Commissionaire Arrangements

A *commissionaire* arrangement is one in which an independent agent, or *commissionaire,* sells products in a state under its own name but on behalf of a foreign enterprise. Under the current definition of "permanent establishment" in the O.E.C.D. Model Tax Convention, an enterprise is able to use a *commissionaire* arrangement to avoid having a permanent establishment in the state where the sale actually occurs, while the *commissionaire*, not being the owner of the assets, only receives remuneration for his services.

This practice has been considered abusive by the O.E.C.D., and hence Article 13 of the M.L.I. amends the definition of permanent establishment to include independent agents who act on behalf of a foreign enterprise and habitually play the principal role in the conclusion of contracts without any material modification by the enterprise.

This amendment is optional for the Contracting States.

2) Specific Activity Exemptions

The work on Action Item 7 led to changes to the wording of Article 5(4) of the O.E.C.D. Model Tax Convention to address situations in which specific activity exemptions give rise to B.E.P.S. concerns. Under the new wording, the activities listed in Article 5(4) will only be deemed not to constitute a permanent establishment if they are of a preparatory or auxiliary character.

This amendment is optional for the Contracting States.

3) Splitting-Up of Contracts

According to the O.E.C.D.'s Final Report on Action Item 7, the segmentation of contracts is another potential strategy for the artificial avoidance of permanent establishment status. The M.L.I. therefore amends the existing 12-month threshold for determining the existence of a permanent establishment to take into account any activities carried out by an enterprise in a jurisdiction during one or more periods of time, which when aggregated, exceed 30 days within the 12-month threshold.

4) Implementation of Action 7 Through the M.L.I.

In July 2020, the O.E.C.D./G-20 Inclusive Framework on B.E.P.S. published a progress report covering July 2019 through July 2020.[70] According to this report, of the 94 jurisdictions that were party to the M.L.I. in June 2020,

- 46 jurisdictions have opted for the changes to Article 5(5) and 5(6) of the O.E.C.D. Model Tax Convention, lowering the threshold for the creation of a dependent agent permanent establishment;

- 55 jurisdictions have opted for the amended Article 5(4) of the O.E.C.D. Model Tax Convention, with the preparatory or auxiliary requirement;

- 54 jurisdictions have opted for the anti-fragmentation rule in Article 5(4.1) of the O.E.C.D. Model Tax Convention; and

- 34 jurisdictions have opted for the anti-contract splitting provision included in the Commentary on Article 5 of the O.E.C.D. Model Tax Convention.

70 O.E.C.D. (2020), *O.E.C.D./G20 Inclusive Framework on BEPS: Progress report July 2019 – July 2020*.

d. Dispute Resolution and Arbitration

The M.L.I. provides methods for the implementation of a minimum standard for improving dispute resolution, which were developed in Action Item 14.

If a taxpayer considers that the actions of one or both Contracting States result or will result in taxation not in accordance with the provisions of the tax treaty, the taxpayer may present its case to the competent authority of either Contracting State. However, the case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the tax treaty. Both Contracting States should endeavor to resolve the case by mutual agreement with a view to the avoidance of the tax measure that is supposedly inappropriate and for that reason is under dispute. Any agreement reached shall be implemented without a time limit.

Article 17 of the M.L.I. introduces a mandatory corresponding adjustment of tax charged on profits in one Contracting State in cases where the other Contracting State has included a portion of those taxable profits under applicable transfer pricing rules.

An optional clause for mandatory binding arbitration is contained in the M.L.I. that would allow participating countries to limit the cases eligible for arbitration based on reciprocal agreements.

The minimum standard is subject to a peer review process. As of May 2019, 45 jurisdictions had been reviewed and around 990 recommendations for improvement have been issued to these jurisdictions. The monitoring process (*i.e.*, stage 2) is underway. As of April 14, 2022, 82 Stage 1 peer review reports and 69 Stage 1 and Stage 2 peer monitoring reports have been published.

e. Reservations

No reservations may be made to the M.L.I. except those expressly permitted. However, the M.L.I. accepts that in most cases a Contracting State will assert some reservations.

f. **Timing**

The M.L.I. has been open for signature since December 31, 2016. A formal signing ceremony was held in Paris on June 7, 2017. Following signature, Contracting States must complete the domestic procedures necessary to ratify the M.L.I.

Following ratification, the Contracting States must notify the Depositary and provide a list of Covered Treaties and options.

The M.L.I. will then enter into force between the Contracting States on the first day of the month following the expiration of a period of three calendar months, beginning on the date when notification of ratification was deposited with the O.E.C.D.

The provisions of the M.L.I. will then affect a Covered Treaty with respect to

- taxes withheld at the source on the first day of the next calendar year that begins on or after the date on which the M.L.I. entered into force between the Contracting States; and

- all other taxes for taxable periods following the expiration of a period of generally six calendar months after the date on which the M.L.I. entered into force between the Contracting States.

As of June 1, 2025, out of the 104 jurisdictions that are currently a party to the M.L.I., 88 have deposited instruments of ratification.

iii. **Conclusion**

One important question that remains is whether the M.L.I. will lead to increased consistency or add further complexity to the international tax system. Considering the M.L.I.'s flexibility and various available options, it is possible that its application will be highly complex and lead to uncertainty. Such flexibility may even be contrary to the idea of countering B.E.P.S. in a comprehensive and coordinated manner. However, considering the massive variation across global economies and politics, it seems impossible to compose one set of tax treaty provisions that would accommodate all states in the foreseeable future. Therefore, without a doubt, differences across treaty texts will remain.

Nonetheless, implementing these provisions through the M.L.I. rather than bilateral negotiation enables the minimization of differences across treaty texts and the harmonization of the interpretation and application of tax treaties.

L. Concluding Remarks on the E.U.'s Action

The E.U. has been addressing the B.E.P.S. Action Plan through the adoption of several E.U. directives in a wide and coordinated response to the O.E.C.D.'s recommendations.

In this respect, the E.U. has already adopted the following directives:

- E.U. Council Directive 2015/2376 on the automatic exchange of cross-border rulings or advance pricing arrangements (in response to Action Item 5),

- E.U. Council Directive 2016/881 on the reporting by multinational companies of specified tax-related information, along with the exchange thereof, between E.U. countries (in response to Action Item 13), and

- E.U. Council Directive 2016/1164 and E.U. Council Directive 2017/952, known as the Anti-Tax Avoidance Directives ("A.T.A.D.").

It is noteworthy that the measures included in the A.T.A.D. follow the principles set out by the B.E.P.S. Report in regard to

- hybrid mismatches (Action Item 2),

- C.F.C. rules (Action Item 3),

- limitation on interest deductions (Action Item 4), and

- the G.A.A.R. (Action Item 6).

On May 29, 2017, the E.U. Council adopted a directive to amend the A.T.A.D. ("A.T.A.D. 2") in order to extend the scope of the provisions on hybrid mismatches from E.U. Member States to include third countries and align the A.T.A.D. with the recommendations of Action Item 2. The A.T.A.D not only implements the B.E.P.S. Project's minimum standards, but even surpasses them with the addition of exit taxation and the use of broader definitions.

On March 21, 2018, the E.U. Commission proposed two additional directives on the taxation of digital business activities to implement Action Item 1 of the B.E.P.S. Action Plan. The first proposal lays down rules relating to the corporate taxation of a significant digital presence, while the second proposal provides for the introduction of a common system of digital services taxation for revenues resulting from the performance of certain digital services. On March 12, 2019, the E.U. Council failed to reach an agreement on an E.U. digital services tax, which was based on a new compromise limiting the scope to digital advertising services.

The E.U. Commission's more recent effort to build on the O.E.C.D. GloBE rules discussed above has been more successful: its December 2021 proposal to ensure a global minimum level of taxation for multinational enterprises within the E.U. and to expand the scope of the GloBE rules to domestic groups was adopted by the Council of Ministers in December 2022 and is now known as the E.U. Minimum Tax Directive (2022/2523).

The E.U. Minimum Tax Directive required the Member States to transpose the rules into domestic law by December 31, 2023. Essentially, this means that the GloBE rules are now transposed into E.U. secondary law, meaning that the global minimum effective rate of corporate taxation, at an agreed minimum rate of 15%, now applies to multinational enterprises as well as large-scale domestic groups based in the E.U.

Furthermore, on September 12, 2023, the E.U. Commission published two proposals for a Council Directive, both intended to reduce tax compliance costs for large, cross-border businesses in the E.U.

The first proposal concerns the Council Directive on Business in Europe: Framework for Income Taxation ("B.E.F.I.T."). This introduces a common corporate tax framework to compute the taxable base at the level of a single entity of the relevant group company. These tax bases are then aggregated at the E.U. group level and ultimately reallocated to the relevant E.U. Member States. If the B.E.F.I.T. Directive is adopted, it is scheduled to come into force on July 1, 2028.

In addition to its B.E.F.I.T. proposal, the European Commission published a separate Council Directive proposal on transfer pricing (the "T.P. Directive"), which essentially builds on the O.E.C.D. Transfer Pricing Guidelines. If the Member States reach an agreement on this T.P. Directive, it would enter into force on January 1, 2026. If adopted, both proposals will have to be implemented by each Member State. As all Directives related to tax, adoption of the Directive will require unanimous approval by the E.U. Member States.

4. European Tax Law[1]

Because each of the E.U. Member States is free to decide its own economic policy and direct taxes are not harmonized across the E.U., there is strong tax competition within the E.U. market. Efforts to ensure a level playing field with respect to direct taxation have sparked several initiatives at the E.U. level. Currently, the discussion focuses on the key issues of State Aid, transparency measures, reporting standards, and most recently, measures aimed at combatting tax avoidance. Also, in recent years, the E.U. has recognized the need to simplify European tax law and reduce compliance costs.

A. State Aid

i. Legal Framework and Definition of "State Aid"

Pursuant to Article 107 §1 of the Treaty on the Function of the European Union ("T.F.E.U."), any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings is incompatible with the internal market, insofar as it affects trade between Member States. A measure qualifies as "State Aid" if it falls under the following criteria:

1 This chapter of the article was written by Matthias Scheifele of Hengeler Mueller in Munich.

- The relevant intervention is granted by a Member State or through state resources.[2]

- The intervention provides an economic advantage to the recipient.[3]

- The intervention distorts or threatens to distort competition and affects or may affect trade between the Member States.[4]

- The advantage is selective, *i.e.*, it is only granted to specific recipients.

Even if a measure meets the foregoing criteria, to be considered State Aid within the meaning of Article 107 §1 T.F.E.U., it may not be unlawful if one of the exemptions provided in Article 107 §§2 or 3 T.F.E.U. applies. For example, State Aid may be compatible with the internal market if it has a social character and is granted to individual consumers, eliminates damages caused by natural disasters or exceptional occurrences.[5] In addition, the following may also be considered to be compatible with the internal market:[6]

---

2 Commission Notice, 1998 O.J. C 384/03, ¶10 [hereinafter "State Aid and Direct Business Taxation"]; replaced by Commission Notice, 2016 O.J. C 262/01, ¶47 [hereinafter "State Aid in the T.F.E.U."].

3 State Aid in the T.F.E.U., *supra* note 2, ¶66.

4 *Id.*, ¶185; according to the European Commission, these are two distinct elements, even, however, they are often treated jointly (State Aid in the T.F.E.U., *supra* note 2, ¶186).

5 Consolidated Version of the Treaty on European Union art. 107, 2012 O.J. C 326/47, §2 [hereinafter "T.F.E.U."]; The Commission views the COVID-19 outbreak as an exceptional occurrence; Commission Press Release, IP/20/454 (March 12, 2020).

6 *Id.*

- Aid to promote the economic development of certain areas[7]

- Aid promoting the execution of projects of common interest or to remedy serious disturbances in the economy of a Member State[8]

- Aid to facilitate the development of certain economic activities or areas without affecting trading conditions[9]

- Measures promoting culture and heritage conservations without affecting trading conditions and competition[10]

- Other categories of aid as specified by decision of the European Council upon proposal by the European Commission[11]

Article 108 §3 T.F.E.U. provides that if a Member State intends to implement a new State Aid measure, it must notify the Commission. Pursuant to Article 108 §1 T.F.E.U., existing State Aid measures are constantly reviewed by the Commission. However, the T.F.E.U. contains neither detailed provisions regarding the notification procedure nor the review of existing State Aid or the recovery of unlawful State Aid. However, Article 109 T.F.E.U. authorizes the Council (upon proposal by the Commission and after consulting the Parliament) to implement regulations deemed appropriate regarding

---

7 *Id.,* §3(a).

8 *Id.,* §3(b). In particular, this exemption was of importance in the context of the financial crises. See also *Blumenberg/Kring*, IFSt Nr. 473, 2011, p. 21(f). Also in the context of the COVID-19 outbreak, a State Aid Temporary Framework to support the economy is based on this exemption; Commission Press Release, IP/20/570 (April 3, 2020) and STATEMENT/20/479 (March 17, 2020).

9 *Id.,* §3(c).

10 *Id.,* §3(d).

11 *Id.,* §3(e).

the application of the State Aid provisions, which the Council did in adopting Council Regulation 2015/1589/E.U. (the "Procedural Regulation").[12]

Pursuant to the Procedural Regulation, the Commission decides whether a proposed measure constituting State Aid is compatible with the internal market.[13] After notice but prior to the Commission's authorization, proposed State Aid measures must not be put into effect.[14] If the Commission finds that existing State Aid is incompatible with the internal market, it must decide whether the Member State granting the State Aid should amend or abolish the measure within a period of time as determined by the Commission.[15] State Aid must be recovered from the beneficiary unless the recovery of the aid would be contrary to a general principle of E.U. law.[16]

ii. <u>Application of State Aid Rules to Direct Business Taxation</u>

The principle of incompatibility of State Aid with the internal market applies to aid "in any form whatsoever."[17] As a consequence, national provisions regarding direct business taxation may be considered State Aid if the definitional criteria of the T.F.E.U. are met. In 1998, the Commission clarified these criteria with respect to national tax provisions in the Commission Notice on the application of State Aid rules to measures relating to direct business taxation.[18]

---

12 Council Regulation 2015/1589/E.U. on the Application of Article 108 of the T.F.E.U. (codification), 2015 O.J. L 248/9.

13 *Id.*, art. 9.

14 *Id.*, art. 3.

15 T.F.E.U., *supra* note 5, art. 108, §2.

16 Procedural Regulation, *supra* note 12, art. 16, §1.

17 State Aid and Direct Business Taxation, *supra* note 2, ¶2.

18 *Id.*, *et seq.*

This notice was replaced by the Commission Notice on the notion of State Aid in 2016, which is not limited to tax measures but applies to all types of State Aid.

a. Economic Benefit

According to the Commission Notice, a tax measure grants an economic benefit within the meaning of Article 107 §1 T.F.E.U. if it relieves the beneficiary of charges it normally should bear. For instance, an advantage could be provided through a reduction in the tax base by special deductions or depreciation or by setting up reserves in the balance sheet. Tax exemptions, tax credits, deferred payment of taxes, and the cancellation of tax debt are examples of economic benefits that could also be considered advantages.[19] In a 2016 notice, the Commission especially addressed advantages in the form of (i) preferential tax regimes for cooperative societies, (ii) special tax rules governing investment funds, (iii) tax amnesties, (iv) tax rulings and settlements, (v) depreciation and amortization rules, (vi) fixed basis tax regimes for specific activities, (vii) exceptions from anti-abuse-rules, and (viii) excise duties.[20]

b. Benefit Through State Resources

With respect to taxes, an economic benefit can be identified as having been provided by state resources if the tax measure results in a loss of tax revenue. A positive transfer of funds does not have to occur.[21] This applies even if the tax-related State Aid may have an indirect positive overall effect on budget revenue.[22] State support

---

19 *Id.*, ¶9.

20 State Aid in the T.F.E.U., *supra* note 2, ¶156 *et seq.*

21 *Id.,* ¶51

22 Commission Communication Report on the Implementation of the Commission Notice on the Application of State Aid Rules to Measures Relating to Direct Business Taxation, C(2004) 434/1, ¶19.

need not be provided only by legislation. It may be provided through the practices of tax authorities.[23]

c. Negative Impact on Trade and Competition

The distortion of competition and the effect on trade are two distinct criteria, which are often treated jointly in the assessment of State Aid. According to the Commission, a distortion of competition exists when the State grants a financial advantage to an undertaking in a liberalized sector where there is, or could be, competition.[24] Regarding the effect on trade, it is not relevant if the aid has an actual effect on trade between Member States but only whether the aid is liable to affect such trade.[25]

d. Selectivity

The most complex question in the context of State Aid and direct business taxation is whether a tax measure qualifies as selective.

A measure is selective if it favors certain undertakings or the production of certain goods.[26] Therefore, measures of purely general application, which do not favor certain undertakings, cannot be seen as selective. However, even interventions which, at first appearance, apply to undertakings in general may be selective to a certain extent.[27]

Regarding generally applicable measures which mitigate the charges that undertakings would normally have to bear, *e.g.*, tax exemptions for undertakings fulfilling certain criteria, the selectivity is determined by a three-step-analysis. As a first step, the system of reference must be identified. Second, it should be determined whether a given measure constitutes a derogation from that system

---

23 State Aid and Direct Business Taxation, *supra* note 2, ¶10.

24 *Id.,* 187.

25 *Id.,* 190.

26 *Id.,* ¶117.

27 *Id.*, ¶118.

insofar as it differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. If a measure does constitute a derogation, it is *prima facie* selective. In a third step, it has to be determined, whether the derogation is justified by the nature or the general scheme of the (reference) system.[28] The European Court of Justice ("E.C.J.") recently underlined the importance of determining the system of reference solely by looking at national tax law for the reason of recognizing each Member State's tax autonomy. Outside the spheres in which E.U. tax law has been harmonized, only the national law applicable in the Member State concerned must be considered to identify the reference system. In the underlying case, this would have required examining at the detailed application of transfer pricing methods in Luxembourg rather than applying O.E.C.D. Guidelines.[29]

The meaning of this provision and the interpretation of its requirements are unclear, as no official guidance is provided on the way the "nature" or the "general scheme" of a tax system is identified.[30] Moreover, no consensus exists among scholars in legal literature on how to define the tax system in issue. According to the Commission, a justification "by the nature or the general scheme" might be considered if the deviation derives "directly from the basic or guiding principles of the tax system."[31] Since the Commission replaces one ambiguous term with another vague description, only the case law provides concrete guidance regarding what may qualify as acceptable justification.

With respect to the nature or the general scheme of an identified tax system, the Commission holds, that progressive tax rates are justified by the redistributive purposes of income taxes.

---

28 *Id.*, ¶128.

29 E.G.C., Judgment of November 8, 2022, C-885/19 P and C-898/19 P.

30 *Jestaed* in Heidenhain, European State Aid Law, 2010, §8 ¶19.

31 State Aid in the T.F.E.U., *supra* note 2, ¶138.

Furthermore, the need to fight fraud or tax evasion or the need to avoid double taxation are basis for a possible justification.[32] In any case, the Member States are required to provide the Commission with a justification for the deviations during the notification procedure or the examination of potentially unlawful State Aid.[33]

The Commission Notice of 2016 contains comments on specific issues concerning tax measures with regard to the selectivity,[34] *e.g.* for tax amnesties,[35] tax rulings and settlements[36] as well as for depreciation and amortization rules[37] and fixed basis tax regime for specific activities.[38]

iii. Recovery of Unlawful State Aid

If an existing tax provision comprises State Aid within the meaning of Article 107 §1 T.F.E.U. and no exemption within the scope of Article 107 §§2 or 3 T.F.E.U. applies, the Member State is obligated to recover the unlawful State Aid from the beneficiary upon an adverse decision of the European Commission.

The Commission may only refrain from requiring the recovery of unlawful State Aid in two defined cases. Article 14 §1 of the Procedural Regulation provides that no recovery will be required if it would be contrary to a general principle of E.U. law. These general principles provide for an exemption if, for instance, the recovery is absolutely impossible,[39] or if the protection of the doctrine of

---

32 *Id.*, ¶139.

33 *Id.*, ¶141.

34 *Id.*, ¶156 *et seq.*

35 *Id.*, ¶164 *et seq.*

36 *Id.*, ¶169 *et seq.*

37 *Id.*, ¶177 *et seq.*

38 *Id.*, ¶181 *et seq.*

39 *Sinnaeve* in Heidenhain, European State Aid Law, 2010, §32, ¶26.

legitimate expectation overrides the need for recovery.[40] These exemptions are rarely applicable. Further, the recovery of unlawful State Aid is subject to a limitation period of ten years.[41]

Apart from these exceptions and pursuant to Article 16 §1 of the Procedural Regulation, Member States must take all necessary measures to recover the unlawful State Aid from the beneficiary, including interest on the deferred payment.[42] The recovery must be executed immediately and is subject to the national law of the concerned Member State, provided that its national provisions allow the immediate and effective execution of the recovery.

According to case law decided by the E.C.J., national procedural law must be interpreted in a way that does not negatively affect the enforcement of E.U. law (known as the "Supremacy of Community Law").[43] Therefore, national rules providing that an administrative decision cannot be appealed after the expiration of a limitation period[44] or that suspend the effect of the Commission's decision for recovery are not applicable and will not override the obligation to obtain a refund of unlawful State Aid.[45]

iv. Illustrative Examples

a. In General

In the past few years, tax provisions have been subject to increasingly rigorous scrutiny as to whether they constitute State Aid. Investigations in the context of international business taxation

---

40 *Id.,* §32, ¶24.

41 Procedural Regulation, *supra* note 12, art. 17, §1.

42 *Id.,* art. 16, §2.

43 *Land Rheinland-Pfalz v. Alcan Deutschland*, Case C-24/95, [1997] E.C.R. I-01591.

44 *Id.*, ¶38.

45 *Commission v. France*, Case C-232/05, [2006] E.C.R. I-10071.

suggest that the European Commission views aggressive tax planning and tax base erosion by large multinationals as examples of State Aid.[46] Beginning in 2013, the Commission has taken action against tax rulings and similar tax arrangements in individual Member States. In the view of the Commission, the rulings granted by the tax authorities in these Member States were advantageous for the companies involved that they constituted unlawful State Aid. Prominent targets of these investigations include aid to (i) Apple granted by Ireland,[47] (ii) Starbucks[48] and Nike[49] granted by the Netherlands, and (iii) Fiat,[50] Amazon,[51] McDonald's,[52] and Engie[53] granted by Luxembourg.

---

46 Commission Press Release, IP/14/663 (Jun. 11, 2014).

47 Commission Decision No. 2017/1283/E.U. (*Apple*), 2016 O.J. L 187/1. See also *Ireland v. Commission*and *Apple Sales International and Apple Operations Europe v. Commission* (E.G.C. Judgment of July 15, 2020, T-778/16 and T-892/16, ECLI:EU:T:2020:338); Appeal Case E.C.J. Judgment of September 10, 2024, C-465/20 P, ECLI:EU:C:2024:724.

48 Commission Decision No. 2017/502/E.U. (*Starbucks*), 2015 O.J. L 83/88. See also *Netherlands v.* and *Starbucks and Starbucks Manufacturing Emea v. Commission*, E.G.C. Judgment of September 24, 2019, Joined Cases T-760/15 and T-636/16, ECLI:EU:T:2019:669.

49 Commission Press Release, IP/19/322 (January 10, 2019).

50 Commission Decision No. 2016/2326/E.U. (*Fiat*), 2015 O.J. L 351/1. See also E.C.J., Judgment of November 8, 2022, C-885/19 P and C-898/19 P, ECLI:EU:C:2022:859.

51 *State Aid to Amazon*, 2015/C 044/02. See also E.C.J., Judgment of December 5, 2023, C-451/21 P and C-454/21 P, ECLI:EU:C:2023:948.

52 Commission Press Release, IP/18/5831 (Sept. 19, 2018).

53 E.C.J., Judgment of December 5, 2023, C-451/21 P and C-454/21 P, ECLI:EU:C:2023:948.

In the *Amazon* case, the E.C.J. ruled against the Commission. According to the Commission, Amazon artificially inflated the settlement of royalties between various European subsidiaries in order to escape tax payments, which was explicitly approved by the Luxembourg authorities. However, the E.C.J. found that the Commission incorrectly applied the arm's length principle. According to the E.C.J., the arm's length principle can only be applied when it is incorporated into national law.[54] In the Engie case, the E.C.J. determined that the Commission could not substantiate the claim that the tax rulings granted by Luxemburg to companies within the Engie group constituted a selective tax advantage.[55] The E.C.J. therefore overruled the previous judgment of the European General Court ("E.G.C."). The E.G.C. had confirmed the existence of a tax advantage in the tax rulings granted by Luxembourg to companies in the Engie group. In the decision, the court stated that preferential tax treatment resulted from the failure to apply a national measure relating to abuse of law.[56] In the *Nike* case, the E.G.C. stated the lawfulness of the Commission's decision to initiate the formal investigation procedure. Stressing the importance of examining the individual measure, the Court considered whether the Commission's assumption of selectivity met the threshold requirements for the formal investigation procedure without, of course, going into detail regarding the selectivity criteria to be applied.[57]

In the case of Apple, the Commission argued that the transfer prices used were negotiated with Irish tax authorities rather than substantiated by reference to comparable market transactions, and therefore the ruling does not reflect the arm's length principle under appropriate guidance for transfer pricing.[58] The Commission

---

54 *Id.*

55 *Id.*

56 E.G.C., Judgment of May 12, 2021, T-816/17 and T-318/18, ECLU:EU:T:2021:252.

57 E.G.C., Judgment of July 14, 2021, T-648/19, ECLI:EU:T:2021:428.

58 *State Aid to Apple*, C(2016) 5605 Final.

contended that, by allowing an unsubstantiated transfer pricing plan, Ireland granted a selective benefit to Apple by lowering its total tax burden.[59] In the case of Starbucks and Fiat, the European Commission decided that Luxembourg and the Netherlands granted selective tax advantages to Fiat and Starbucks, respectively, by way of tax rulings which confirmed transfer pricing arrangements. These rulings qualify as State Aid because the calculation of intercompany prices did not comply with market terms. By approving the arrangements, the Member States afforded an economic benefit to the companies, but not their competitors, which allowed the companies to allocate profits to low-tax jurisdictions. In its decisions on *Fiat* and *Starbucks*, the Commission set out the methodology to be used to calculate the value of the undue competitive advantage enjoyed by Fiat and Starbucks, *i.e.*, the difference between what the company paid and what it would have paid without the tax ruling. This amount was estimated to be between €20 million and €30 million for each company. The precise amount of tax to be recovered must now be determined by the Luxembourg and Dutch tax authorities.[60]

b. <u>Appeals by Starbucks and Fiat</u>

In September 2019, the respective first instance decisions of the E.G.C. annulled the European Commission's decision regarding Starbucks,[61] whereas it confirmed the decision with respect to Fiat.[62] In both cases, the arm's length principle was found to be an appropriate State Aid standard for determining whether a selective advantage was given to a particular company. If the Commission

59 *Id.*

60 *State Aid to Fiat,* 2015 O.J. L 351/1; *State Aid to Starbucks*, 2015 O.J. L 83/38.

61 *Netherlands and Starbucks and Starbucks Manufacturing Emea v. Commission*, Joined Cases T-760/15 & T-636/16, [2019] ECLI:EU:T:2019:669.

62 *Luxembourg and Fiat Chrysler Finance Europe v. Commission*, Joined Cases T-759/15 & T-755/15, [2019] ECLI:EU:T:2019:670.

can demonstrate that a ruling allowed a company to depart from an arm's length determination of income, the ruling constitutes unlawful State Aid. In comparison, if no such showing is made by the Commission, a finding of unlawful State Aid is not warranted.

Regarding the Starbucks matter, the E.G.C. found that the Commission did not prove a selective advantage was granted by the tax ruling. Even certain methodological deficiencies in the application of the arm's length principal would not, *per se*, indicate the existence of a selective advantage within the meaning of State Aid law. In contrast, the Fiat decision by the E.G.C. confirmed the Commission's assertion that Luxembourg granted selective tax advantages by way of tax rulings that confirmed transfer prices that did not comply with market terms. However, the European Court of Justice ("E.C.J") has annulled the Commission's decision.[63] The Court ruled that the Commission failed to determine the correct system of reference for purposes of qualifying the applied transfer prices as selective. Luxembourg's national tax law should have been subject to a closer assessment of its basic principles; it is not permissible to determine the reference system by merely looking at O.E.C.D. Guidelines which are not automatically incorporated into national law themselves and therefore have no binding authority.

c. Appeal by Apple

In this dispute over a record back tax payment of €13 billion for Apple in Ireland, the first instance decision by the E.G.C. annulled the Commission's decision.[64] The court explained that the Commission failed to prove that Ireland granted the U.S. technology company a legally impermissible tax advantage. However, the E.C.J. annulled the decision of the E.G.C. upholding the Commission's decision. According to the E.C.J., the E.G.C. had

---

[63] E.C.J., Judgment of November 8, 2022, C-885/19 P and C-898/19 P, ECLI:EU:C:2022:859.

[64] E.G.C., Judgment of July 15, 2020, T-778/16 and T-892/16, ECLI:EU:T:2020:338.

erred when it ruled that the Commission had not proved sufficiently the tax advantage.[65]

d. German Restructuring Relief

In February 2016, the E.G.C. confirmed the European Commission's decision[66] that the so-called restructuring relief clause under German corporate tax law that enabled an ailing company to offset its losses in a given year against profits in future years, despite changes in its shareholder structure, amounts to State Aid.[67]

The clause departed from the general principle in the corporate tax law of Germany that prevented the carryforward of losses for fiscal purposes precisely when there has been a significant change in the shareholding structure of the company concerned. The restructuring relief therefore favored ailing companies over financially-sound competitors that suffer losses in a given year. For those competitors, the tax benefit of a carryforward is not allowed when a significant change occurs in their shareholder structure. The clause therefore distorts competition in the single market.

The German authorities' view was that the clause was merely a new technical feature of the German tax system, and for that reason, could escape qualification as State Aid. This argument convinced neither the Commission nor the E.G.C. However, in line with the opinion[68] of Advocate General Wahl, the E.C.J. ruled that the

---

65 E.C.J., Judgment of September 10, 2024, C-465/20 P, ECLI:EU:C:2024:724.

66 Commission Decision No. 2011/527/E.U. (*Sanierungsklausel*), 2011 O.J. L 235/26.

67 *SinnLeffers v. Commission*, Case T-620/11, [2016] E.G.C. ECLI:EU:T:2016:59.

68 Opinion of the Advocate General Wahl, *Dirk Andres (administrator of Heitkamp BauHolding GmbH), previously Heitkamp BauHolding GmbH v. Commission*, Case C-203/16 P, [2017] ECLI:EU:C:2017:1017.

general right to carry forward losses is the relevant reference framework, so that the benefit was not selective. The Commission erred when it viewed forfeiture of loss carryforwards in case of a change of control as the framework.[69]

e. **German Exemption of Waiver Gains**

The increasing relevance of the State Aid rules for individual Member State's tax legislation is further evidenced by Germany's decision to notify the Commission of a new statutory rule providing for an exemption of waiver gains from income tax and trade tax.[70] The Commission responded to the notice by way of an informal and unpublished comfort letter confirming that they do not see any conflict with the State Aid rules.

f. **British C.F.C. rules**

Another illustrative example highlighting the challenges for the Commission in determining the appropriate reference framework for examining whether a selected advantage had been conferred, is the Commission decision[71] finding certain U.K. rules on the taxation of controlled foreign companies to be incompatible with the internal market. In 2019, the Commission found that the U.K. had granted unlawful State Aid by way of exemptions from the British C.F.C. charge. This was based on the reasoning that the relevant reference

---

[69] *Andres (faillite Heitkamp BauHolding) v. Commission*, Case C-203/16 P, [2018] ECLI:EU:C:2018:505; *Germany v. Commission*, Case C-208/16 P, [2018] ECLI:EU:C:2018:506; *Germany v. Commission*, Case C-209/16 P, [2018] ECLI:EU:C:2018:507, *Lowell Financial Services v. Commission*, Case C-219/16 P, [2018] ECLI:EU:C:2018:508; see also *Strüber/von Donat*, IFSt Nr.531, 2019, p 26(ff).

[70] Section 3a *Einkommensteuergesetz – EstG* [hereinafter the "Income Tax Act"] and Section 3a *Gewerbesteuergesetz – GewStG* [hereinafter the "Trade Tax Act"].

[71] Commission Decision No. 2019/1352/E.U., 2019 I.J. L 216/1.

framework for examining whether there was a selective advantage consistent of the rules applicable to C.F.C.'s and that the exemptions from the C.F.C. charge derogated from that framework. This reasoning was challenged before the E.G.C., which upheld the Commission's decision and reasoning for the appropriate reference framework in 2022.[72]

However, the E.C.J. annulled the Commission decision and set aside the judgment of the E.G.C. confirming that decision, by recalling that the Commission, when determining the reference framework, which is the first step in examining the condition of selectivity, is in principle required to accept the Member State's interpretation of the relevant provisions of its national law, unless it is able to establish that another interpretation prevails in the case law or the administrative practice of that Member State. In that context, it states that when, in the light of information provided by the Member State concerned, the Commission does not have, in relation to an aid scheme, case law or an administrative practice of the Member State concerned which substantiates its own interpretation of the national law, that interpretation can prevail over that advocated by that Member State only if the Commission is able to demonstrate that the Member State's interpretation is incompatible with the wording of the relevant provisions.

The U.K. argued that the reference framework to the C.F.C. rules is its general corporation tax system, which is largely based on the principle of territoriality, of which the rules applicable to C.F.C.'s, in their entirety, form part. By contrast, the Commission took the view, which was upheld by the E.G.C., that the appropriate reference framework was to be seen in the British C.F.C. rules. The E.C.J. held the view, that the E.G.C. erred in upholding the Commission decision's reasoning. That error relating to the determination of the reference framework necessarily vitiates the whole of the analysis

72 E.G.C. Judgment of June 8, 2022, T-363/19 and T-456/19, ECLI:EU:T:2022:349.

of the condition relating to selectivity, which therefore was to be annulled.[73]

g. Path Forward

The extensive application of the State Aid rules with regard to direct taxation leads to a conflict with the principle of the autonomy of Member States in the field of taxation, and has been met with increasing criticism.[74] The E.G.C. for the first time examined the legality of a State Aid scheme under Article 107(2)(b) T.F.E.U. in the context of the COVID-19 pandemic and affirmed that State Aid provided in order to enable a company to overcome a crisis is not unlawful.[75] The case involved France, which supported airlines with French operating licenses with a payment moratorium during the pandemic. Ryanair, the holder of an Irish license, saw this as discrimination and filed a lawsuit. The E.G.C. ruled that France's aid measures to support airlines was lawful. In the decision, the E.G.C. pointed to a Commission ruling that a payment moratorium was compatible with the internal market. The moratorium provided that the payment of the monthly civil aviation tax and the solidarity levy on airline tickets from March to December 2020 can be deferred until 2021. According to the Commission, this constituted aid to make good the damage caused by natural disasters or exceptional occurrences (Article 107(2)(b) T.F.E.U.). The E.G.C. agreed with the Commission's view. This was the first time the E.G.C. examined the legality of a State Aid scheme under Article 107(2)(b) T.F.E.U. in the context of the COVID-19 pandemic.[76]

---

[73] E.C.J. Judgment of September 19, 2024, C-555/22 P, C-556/22 P, C-564/22 P, ECLI:EU:C:2024:304.

[74] Opinion of Advocate General *Saugmandsgaard* ØE, delivered on September 19, 2018, Case C-374/17, ECLI:EU:C:2018:741; *Strüber/von Donat*, IFSt Nr.531, 2019, p 67(ff).

[75] E.G.C. Judgment of February 17, 2021, T-259/20.

[76] Further decisions in the context of State Aid schemes during the COVID-19 pandemic: E.G.C. Judgment of April 14, 2021, T-388/20, ECLI:EU:T:2021:196 (upheld by E.C.J.

The E.C.J. ruled that, with the exception of areas of tax law that have been harmonized, the determination of the basic characteristics of a tax provision under the law of a Member State is left to the discretion of that Member State, provided that the exercise of discretion is in accordance with E.U. law.[77] Moreover, E.U. law in the area of State Aid does not prevent Member States from adopting progressive tax rates reflecting the capacity of wealthier taxpayers to pay tax at higher rates than others having lower incomes. Similarly, Member States are not prohibited from using progressive taxation in the context of corporate taxes and taxes on persons with legal identity.

In addition, E.U. law does not preclude progressive taxation linked to turnover. One case involved a retail sales tax in Poland. It was unsuccessfully challenged by the Commission. The turnover tax was found to be a direct tax and the Commission was not able to demonstrate that the progressive nature of the tax rates was designed to circumvent the rules attacking unlawful State Aid.

On March 3, 2021, the E.C.J. ruled with regard to Article 107(1) of the T.F.E.U. that, in accordance with settled case law, levies do not fall within the scope of the provisions of the T.F.E.U. on State Aid unless they constitute the method of financing an aid measure, and as a result, form an integral part of that measure.[78] In the facts of the case presented to the E.C.J., there was no indication that the revenue from the levy of the I.V.P.E.E., a direct tax on the value of the production of electric energy supplied to the Spanish electricity system, constituted a financing method amounting to unlawful State

Judgment of July 16, 2021, C-353/21 P [Finnair I], ECLI:EU:C:2024:437); E.G.C. Judgment of June 22, 2022, T-657/20, ECLI:EU:T:2022:390 (upheld by E.C.J. C-588/22 P) [Finnair II], ECLI:EU:C:2024:935).

77 E.C.J., Judgment of March 16, 2021, C-562/19 P, ECLI:EU:C:2021:201.

78 E.C.J., Judgment of March 3, 2021, C-220/19, ECLI:EU:C:2021:163.

Aid. Consequently, the I.V.P.E.E. did not fall within the scope of the provisions of the T.F.E.U. on State Aid.

In another decision, the E.C.J. found that a Spanish law that lowered the taxes for Spanish football clubs amounted to unlawful State Aid.[79] Spanish law has long allowed specific Spanish football clubs – F.C. Barcelona, Real Madrid, Athletic Bilbao, and Atlético Osasuna – to pay lower taxes than most of its competitors. The basis of the lower tax was their characterization as non-profit organizations. The Court confirmed the Commission's view that the tax advantages provided by the law constituted unlawful State Aid, irrespective of other tax issues that also played a role. Although an aid scheme must always be considered as a whole, it is not necessary to determine the exact advantage that the beneficiary ultimately derives in order to establish the existence of aid. The quantification of the amount of the unlawful State Aid is deferred until the time of a recovery action by the Member State. The decisive factor, according to the E.C.J., was that the aid scheme was applied to favor the four football clubs but not their competitors, all of whom operated as stock corporations. Consequently, the advantage violated Article 107(1) T.F.E.U.

Another Spanish tax regime that was found to constitute unlawful State Aid related to certain finance lease agreements concluded by shipyards.[80] The E.G.C. found that the use of the tax scheme at issue was granted by the tax administration based on vague criteria for which no framework apparently existed. Specifically, the tax administration could determine the date of commencement of depreciation on the basis of criteria that were defined in such a way as to give the tax administration a significant margin of discretion. As a result, companies that received rulings were in a better position than other taxpayers with comparable facts. Consequently, the conditions relating to the risk of distortion of competition and its effect on trade between Member States were met. The E.C.J. upheld

---

79 E.C.J., Judgment of March 4, 2021 - C-362/19 P, ECLI:EU:C:2021:169.

80 E.G.C., Judgment of September 23, 2020, T-515/13 RENV and T-719/13 RENV, ECLI:EU:T:2020:434.

the E.G.C.'s decision that the Spanish tax regime constituted unlawful State Aid, particularly that the State Aid was selective.[81]

On April 17, 2024, the E.G.C. affirmed the Commission's decision[82] that a law under which only credit institutions that exceed a certain profit threshold are subject to tax is in accordance with the reference system of Swedish tax law and therefore does not constitute unlawful State Aid.[83] One of the reasons provided by the E.G.C. was that, according to the explanatory memorandum to the Swedish law, this system serves to offset indirect costs that would be incurred in the event of a crisis, particularly by credit institutions that exceed the profit threshold.

h. Application of State Aid Rules to Third Countries

On December 23, 2022, the European Union adopted Regulation 2022/2560 of the European Parliament and of the Council on foreign subsidies distorting the internal market (the Foreign Subsidies Regulation or "F.S.R.").[84] The purpose of the F.S.R. is to give the Commission the power to effectively deal with distortions in the internal market caused by foreign subsidies to ensure a level playing field. This includes a requirement for companies to notify the Commission of both M&A transactions and public tenders if the parties involved have received foreign financial contributions as well as *ex officio* investigations.

This means that in addition to the necessary regulatory approvals which have to be considered in the context of transactions, F.S.R.

---

81 E.C.J., Judgment of February 2, 2023, C-649/20 P and C-662/20 P, ECLI:EU:C:2023:60.

82 Commission Decision 2021/8637/E.U.

83 E.G.C., Judgment of April 17, 2024, T-112/22, ECLI:EU:T:2024:250.

84 Council Regulation 2022/2560/E.C. on foreign subsidies distorting the internal market, 2022 O. J. L 330/1.

presents an additional set of necessary regulatory procedures to be considered.

According to Article 3 of the F.S.R., a foreign subsidy shall be deemed to exist where a third country provides, directly or indirectly, a financial contribution which confers a benefit on an undertaking engaging in an economic activity in the internal market and which is limited, in law or in fact, to one or more undertakings or industries. For the purposes of the regulations, a financial contribution is defined as any of the following items, among other explicitly named tax advantages:

- The transfer of funds or liabilities, such as capital injections, grants, loans, loan guarantees, fiscal incentives, compensation for financial burdens imposed by public authorities, debt forgiveness, debt to equity swaps or rescheduling

- The foregoing of revenue that is otherwise due, such as tax exemptions or the granting of special or exclusive rights without adequate remuneration

- The provision of goods or services or the purchase of goods or services

The Commission has published a document of initial clarifications on certain aspects of the F.S.R. in July 2024[85] and regularly updates the Q&A section on its website, which is prepared by the Commission services and is not binding on the European Commission as an institution or the Union Courts.[86]

---

85 Commission Staff Working Document, July 26, 2024, SWD(2024) 201 final.

86 Questions and Answers - European Commission: available at https://competition-policy.ec.europa.eu/foreign-subsidies-regulation/questions-and-answers_en.

B. Transparency Measures

The increasing relevance of State Aid proceedings in the area of direct taxes illustrates that not only the O.E.C.D., with its work on the B.E.P.S. Project, but also the E.U., is engaged in combatting base erosion and profit shifting. State Aid investigations are not the only tool in this context. The current discussion also focuses on transparency and the broadening of those transparency measures.

i. Current Measures

Currently, Council Directive 2011/16/E.U. (the "Administrative Cooperation Directive"), as amended,[87] lays down the provisions for the cooperation of Member States in the exchange of information that may be relevant to the administration of domestic tax law. On June 2, 2020, the Council approved the conclusions on the Directive.[88] The conclusions stress that efforts to improve administrative cooperation to fight tax fraud and tax evasion are particularly relevant in the context of the need for recovery from the crisis caused by the COVID-19 pandemic.[89] Furthermore, it notes that the Directive does not provide for a procedure relating to data protection in the event of a data breach and calls on the Commission to suggest appropriate substantive amendments to the Directive or other relevant E.U. legislation. Meanwhile, it is appropriate to

---

87 Council Directive 2011/16/E.U. on Administrative Cooperation in the Field of Taxation, 2011 O.J. L 64/1 [hereinafter the "Administrative Cooperation Directive"], amended by Council Directive 2014/107/E.U., 2014 O.J. L 359/1; Council Directive 2015/2376/E.U., 2015 O.J. L 332/1; Council Directive 2016/881/E.U., 2016 O.J. L 146/8; Council Directive 2016/2258/E.U., 2016 O.J. L 342/1; Council Directive 2018/822/E.U., 2018 O.J. L 139/1; Council Directive 2020/876/E.U., 2020 O.J. L 204/46 and Council Directive 2021/514/E.U., 2021 O.J. L 104/1.

88 Council of the European Union, *Council conclusions on the future evolution of administrative cooperation in the field of taxation in the EU,* June 2, 2020, 8482/20.

89 *Id.,* No. 5.

continue work on rapidly finding an administrative solution with the objective of improving the security of data exchanged between the authorities involved in tax information exchange and acting as data controllers.[90] The Member States should also establish a common standard at E.U. level for the reporting and tax information exchange mechanisms of income (revenue) generated through digital platforms.[91]

Pursuant to this Directive, Member States are obligated to share information that is foreseeably relevant to the administration of all taxes (except for V.A.T. and customs duties, excise duties, and compulsory social contributions) of another Member State in five different situations.[92]

a. Mandatory Automatic Exchange of Information

The tax authorities of a Member State must communicate any available information regarding taxable periods beginning on or after January 1, 2014, concerning residents in another Member State relating to income from

- employment;
- director's fees;
- life insurance;
- pensions;
- the ownership of and income from immovable property;

90 *Id.,* No. 14.

91 *Id.,* No. 8.

92 Administrative Cooperation Directive, *supra* note 87, art. 2, §2.

- royalties; and[93]

- from January 1, 2026, non-custodial dividend income other than income from dividends exempt from corporate income tax.[94]

Council Directive 2014/107/E.U. of December 9, 2014, significantly expanded the scope of information that must be transmitted on a mandatory basis. Pursuant to the amended Administrative Cooperation Directive, Member States must communicate personal data with respect to custodial and depository accounts, the account balance as of the end of a calendar year, and the total gross amount of interest, dividends, and gains from the disposal of financial assets credited to the concerned account.[95]

Since its amendment on December 8, 2015, the Administrative Cooperation Directive also provides for the automatic exchange of information regarding, *inter alia*, the following types of cross-border tax rulings and advance pricing arrangements, effective as of January 1, 2017:

- Unilateral advance pricing arrangements and/or decisions

- Bilateral or multilateral advance pricing arrangements and decisions

- Arrangements or decisions determining the existence or absence of a permanent establishment

---

93 As of January 1, 2023. Administrative Cooperation Directive, *supra* note 87, art. 8, §1.

94 Administrative Cooperation Directive, *supra* note 87, art. 8, §1. as amended by Council Directive 2023/2226/E.U.

95 *Id.,* art. 8, §3(a), as amended by Council Directive 2014/107/E.U., *supra* note 87.

- Arrangements or decisions determining the existence or absence of facts with a potential impact on the tax base of a permanent establishment

- Arrangements or decisions determining the tax status of a hybrid entity in one Member State which relates to a resident of another jurisdiction

- Arrangements or decisions on the assessment basis for the depreciation of an asset in one Member State that is acquired from a group company in another jurisdiction[96]

The Commission will develop a secure central directory to store the information exchanged. This directory will be accessible to all Member States and, to the Commission for purposes of monitoring the correct implementation of the directive.

b. Spontaneous Exchange of Information

Member States must also spontaneously communicate information in several expanded circumstances:

- The Member State supposes that there may be losses of tax in another Member State.

- A tax exemption or reduction in one Member State might give rise to an increasing tax liability in another Member State.

- Business dealings between two persons are conducted in a way that might result in tax savings.

- The tax authority of a Member State supposes that tax savings may result from an artificial transfer of profits between groups of enterprises.

---

[96] *Id.,* art. 8a, as amended by Council Directive 2015/2376/E.U., *supra* note 87.

- Information forwarded to a Member State has enabled information to be obtained which might be relevant for taxation in the other Member State.[97]

c. Exchange of Information on Request

Member States must exchange information on taxes that may be relevant to another Member State upon request of the other Member State.[98]

d. Country-by-Country Reporting

The amendment of the Administrative Cooperation Directive by Council Directive 2016/881/E.U. of May 25, 2016,[99] introduced rules requiring multinational companies to report certain tax-related information and the exchange of that information between Member States. Under the new rules, multinational groups of companies located in the E.U. or with operations in the E.U. having a total consolidated revenue equal to or greater than €750 million will be obligated to file a Country-by-Country ("C-b-C") Report. The competent national authority that receives the C-b-C Report must communicate the report by automatic exchange to any other Member State in which one or more constituent entities of the multinational group are either resident for tax purposes or are subject to tax with respect to business carried out through a permanent establishment. The C-b-C Report is filed in the Member State in which the ultimate parent entity of the group or any other reporting entity is a resident for tax purposes. The report must

---

97 *Id.*, art. 9, §1.

98 *Id.*, art. 5.

99 *Supra* note 87. The directive is the first element of a January 2016 package of Commission proposals to strengthen rules against corporate tax avoidance. The directive builds on the 2015 O.E.C.D. recommendations to address base erosion and profit shifting and will implement O.E.C.D. B.E.P.S. Action 13, on country-by-country reporting by multinationals.

include the following information for every tax jurisdiction in which the group is active:

- Amount of revenue
- Profit (loss) before income tax
- Income tax paid (on cash basis)
- Income tax accrued (current year)
- Stated capital
- Accumulated earnings
- Number of employees
- Tangible assets other than cash and cash equivalents

In general, C-b-C Reports must be provided within 15 months of the last day of the fiscal year of the reporting multinational group. The rule is somewhat different for the first C-b-C Reports. The first reports must relate to the reporting group's fiscal year commencing on or after January 1, 2016, and must be submitted within 18 months of the last day of that fiscal year.[100]

Germany implemented the provisions relating to C-b-C Reporting and the automatic exchange of cross-border tax rulings and advance pricing arrangements into law on December 20, 2016.[101]

---

100 *Id.*, art. 1, ¶2.

101 *Gesetz zur Umsetzung der Änderungen der E.U.-Amtshilferichtlinie und von weiteren Maßnahmen gegen Gewinnverkürzungen und -verlagerungen (B.E.P.S.-Umsetzungsgesetz) v.* 23.12.2016, BGBl. I 2016, p. 3000 ["Law for the Implementation of the Amendments to the Administrative Cooperation Directive and of Further Measures Against Base Erosion and Profit Shifting"].

e. Mandatory Exchange of Information of Tax Cross-Border Arrangement

On May 25, 2018, the Ecofin Council of Economic and Finance Ministers adopted the Council Directive 2018/822/E.U., which amended Council Directive 2011/16/E.U. and entered into force on June 25, 2018. This directive addresses mandatory automatic exchange of information in the field of taxation of reportable cross-border models as a tool to prevent aggressive cross-border tax arrangements. Under the new rules, an external adviser ("intermediary") who designs, markets, organizes, or makes a model available for use or controls the implementation of the model is required to report any tax arrangement that generates an abusive tax benefit identified in Annex IV of Council Directive No. 2018/822/E.U. (*Hallmarks*).

A reportable cross-border tax arrangement must be identified by hallmarks, at least one of which must be present. Some of these hallmarks may only be taken into account where they fulfil the "main benefit test." That test will be satisfied if it can be established that the expectation of a tax advantage is the main benefit or one of the main benefits, having regard to all relevant facts and circumstances, for entering into an arrangement.[102]

- Hallmarks linked to the main benefit test include the following:
- Performance-based fees[103]
- Standardized structures (that are available to more than one relevant taxpayer without a need to be substantially customized for implementation)[104]

---

[102] Administrative Cooperation Directive, *supra note* 87, Annex IV, Part I.

[103] *Id.,* Annex IV, Part II.A.2.

[104] *Id.,* Annex IV, Part II.A.3.

- Inappropriate legal steps to exploit losses[105]
- Conversion of income into non-taxed or low-taxed income[106]
- Circular transactions through intermediate companies without economic activity[107]
- Exploitation of territories with no corporate tax or a rate close to zero[108]
- Cross-border payments between two or more associated enterprises in tax jurisdictions with tax exemptions or preferential tax regimes[109]

Other hallmarks exist even if the expectation of a tax advantage is not among the main benefits for entering the transaction. Where such other hallmarks exist, reporting is required in all circumstances. These hallmarks include the following:

---

105 *Id.,* Annex IV, Part II.B.1.

106 *Id.,* Annex IV, Part II.B.2.

107 *Id.,* Annex IV, Part II.B.3.

108 *Id.,* Annex IV, Part II.C.1.(b).(i).

109 *Id.,* Annex IV, Part II.C.1.(c) and (d).

- Payments between two or more associated enterprises where the recipient is not resident for tax purposes in any tax jurisdiction[110] or is resident in an E.U. blacklisted tax jurisdictions[111]

- Transfers of assets between two tax jurisdictions with substantially different valuations[112]

- Specific transfer pricing structures (*e.g.*, arrangement which involves the use of safe-harbor-rules or arrangement involving the transfer of hard-to-value intangibles)[113]

The report must be provided by the intermediary, or if the intermediary benefits from a professional privilege, by the user within 30 days of the first act of implementation of the tax model or within 30 days after the tax model has been made available to the users. The competent national authority that receives the tax model reporting must communicate the report by automatic exchange to any other Member State. The report must include the following information for every tax jurisdiction in which the group is active:

- Personal data of the intermediary (user)

- Summary of the tax model

- Characteristics constituting the reporting

- Date of implementing tax model

- Provisions on which the tax model is based

In general, the provisions apply from July 1, 2020, in all cases where the first act of a reportable cross-border arrangement was

---

110 *Id.,* Annex IV, Part II.C.1.(a).

111 *Id.,* Annex IV, Part II.C.1.(b).(ii).

112 *Id.,* Annex IV, Part II.C.4.

113 *Id.,* Annex IV, Part II.E.

implemented after June 24, 2018. If the first act was implemented after June 24, 2018, but before July 1, 2020, the notification must be submitted by August 31, 2020. However, for those arrangements being implemented before July 1, 2020, the reporting is not afflicted with penalties.

Violations of the notification obligation are to be punished with a fine. The amount of the fine varies considerably between the E.U. Member States. Whereas, in some Member States, *e.g.* Latvia or France, the fine is less then €10,000, in other countries, the penalties are much higher. In the Netherlands, the fine can be up to €870,000 and in Poland even up to approximately €5 million. In Germany, the fine amounts up to €25,000.

f. <u>C-b-C Reporting Requirements for Platform Operators</u>

The amendment of the Administrative Cooperation Directive by Council Directive 2021/514/E.U. of March 22, 2021 ("D.A.C. 7") introduced reporting requirements for platform operators regarding transactions with registered vendors under certain conditions.[114]

g. <u>Information Exchange and Reporting Requirements Regarding Crypto Assets</u>

As of January 1, 2026, Directive 2023/2226/E.U. ("D.A.C. 8") amending Council Directive 2011/16/E.U. will take effect.

This directive primarily concerns the reporting and automatic exchange of information on income from transactions in crypto-assets and information on advance rulings for the wealthiest individuals.

---

[114] *Id.,* art. 8ac, as amended by Council Directive 2021/514/E.U.

h. Information Exchange on Minimum Effective Corporation Taxation

On March 11, 2025, the Council reached a political agreement on a new E.U. directive to further expand transparency rules ("D.A.C. 9") which will have to be implemented by December 31, 2025.

This directive primarily concerns the enhancement of cooperation and information exchange on minimum effective corporate taxation. It simplifies reporting for large corporations to better fulfill the filing obligations that taxpayers are facing under Pillar Two requirements and further enhances data exchange between tax authorities.

D.A.C. 9 intends to create an E.U.-wide basis for the automatic exchange of information on GloBE Information Returns. Companies falling under the Pillar Two regulations will be able to file their GloBE Information Returns centrally in only one member state.

ii. Framework for Business Taxation ("B.E.F.I.T.")

On September 12, 2023, the European Commission adopted a proposal for a Council Directive on Business in Europe: Framework for Income Taxation ("B.E.F.I.T.").[115] The proposal would establish a new, common set of rules for determining the tax base of groups of companies in the E.U. The proposal stipulates that groups operating in the E.U. with a combined annual turnover of at least €750 million would be required to submit a single tax return to the tax administration of a Member State that covers the tax bases of all group members. Smaller groups would be able to opt in as long as they prepare consolidated financial statements.

A political discussion on B.E.F.I.T. has not yet been reached by the Member States. The Ecofin (Economic and Financial Affairs Council) has deemed further reflection and technical work to be

---

115 COM (2023) 532 Final.

necessary in advance to determine the next steps in the negotiations for B.E.F.I.T.[116]

iii. Public Tax Transparency Rules for Multinationals

Pursuant to Directive 2021/2101/E.U. amending Directive 2013/34/E.U., the ultimate parent undertaking is obligated to publish an income tax information report for the previous financial year if the group has had a consolidated revenue in excess of €750 million for each of the last two consecutive financial years, as reflected on their consolidated financial statements. In the event that the parent company has its registered office abroad, a branch in a Member State may be required to publish the report.[117] The report must be published on the undertaking's website or, in certain instances, on the website of a subsidiary or affiliated undertaking.[118] If a foreign parent company has a branch in a Member State, the branch or the undertaking that opened the branch (or an affiliated undertaking) must publish the report on its website.[119] The income tax information report contains data on all activities of the ultimate parent company and the affiliated companies.[120] For example, the income tax information report must contain a brief description of the nature of their activities, the number of employees on a full-time or equivalent basis, the amount of profit or loss before income tax, and the amount of income tax accrued during the relevant financial year.[121] The report on income tax information must be published within 12 months of the balance sheet date of the financial year for

---

116 Council of the European Union, Ecofin report to the European Council on tax issues of December 10, 2024, FISC 267, Ecofin 1481, 16673/24.

117 Council Directive 2021/2101/E.U., art. 48b, §5.

118 *Id.*, art. 48d, §2.

119 *Ibid.*

120 Council Directive 2021/2101/E.U., art. 48c, §1.

121 For further details see Council Directive 2021/2101/E.U., art. 48c, §2.

which the report is drawn up.[122] Importantly, the report must be accessible on the website for a minimum of five consecutive years.[123] The Member States were required to implement the laws, regulations, and administrative provisions necessary to comply with the Directive by June 22, 2023.[124]

iv. Mandatory use of International Accounting Standards

Regarding reporting standards, the E.U. legal framework distinguishes between listed companies and companies in the legal form of limited liability companies or limited partnerships.

With respect to listed companies, Council Regulation 1606/2002/E.C., as amended,[125] grants the European Commission the authority to adopt the International Financial Reporting Standards, the International Accounting Standards, and the related Interpretations ("S.I.C./I.F.R.I.C.-Interpretations") issued by the International Accounting Standards Board ("I.A.S.B.").[126] On this legal basis, the Commission adopted a set of international financial reporting standards by issuing Commission Regulation 2023/1803/E.U.[127] As a result, the international financial reporting standards are directly applicable in the domestic legislation of all Member States. If the I.A.S.B. issues new or amended standards or

---

122 *Id.*, art. 48d, §1.

123 *Id.*, art. 48d, §4.

124 *Id.*, art. 2, §1.

125 Council Regulation 1606/2002/E.C. on the Application of International Accounting Standards, 2002 O.J. L 243/1 [hereinafter "Application of I.A.S."], as amended by Council Regulation 297/2008/E.C. on the Implementing Powers Conferred on the European Commission, 2008 O.J. L 97/62.

126 Application of I.A.S., *supra* note 125*,* art. 2 and art. 3, §1.

127 Commission Regulation 2023/1803/E.U. Adopting Certain International Accounting Standards, 2023 O.J. L237/1.

interpretations, the adoption of these new provisions follows a complex endorsement process.[128] Therefore, the I.A.S. Regulation is amended on a continuing basis.

Besides the use of international financial reporting standards, further reporting requirements for listed companies arise from the Transparency Directive[129] and the Prospectus Regulation.[130]

- Pursuant to the Transparency Directive, issuers are required to inform the public market periodically about their financial statements and their management report.[131]

- Pursuant to the Transparency Directive, shareholders of listed companies are subject to reporting obligations if their voting rights exceed or fall below defined thresholds following an acquisition or a disposal of shares.[132]

- Pursuant to the Prospectus Regulation, which is directly applicable in the domestic legislation of all Member States, issuers of securities offered to the public are obliged to

---

128 For further details regarding the endorsement process, see Application of I.A.S., *supra* note 125, art. 6, and Council Regulation No. 182/2011/E.U., 2011 O.J. L 55/13, art. 5.

129 Council Directive 2008/22/E.C. on the Harmonization of Transparency Requirements in Relation to Information About Issuers Whose Securities are Admitted to Trading on a Regulated Market, 2008 O.J. L 76/50 [hereinafter the "Transparency Directive"].

130 Council Regulation 2017/1129/E.C. on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading on a Regulated Market, and Repealing Directive 2003/71/E.C. Text with EEA Relevance, 2017 O.J. L 168/1264 [hereinafter the "Prospectus Regulation"].

131 Transparency Directive, supra note 129, Chapter II.

132 *Id.*, Chapter III.

publish a comprehensive prospectus reporting information concerning the issuer and the securities to be offered.[133]

Companies in the legal form of limited liability companies or in the legal form of partnerships, whose partners have limited liability, fall under the scope of the Accounting Directive.[134] The Accounting Directive requires these entities to present their annual financial reports in compliance with the general principles set forth in the directive. These provisions broadly cover an entity's balance sheets, profit and loss accounts, notes on financial statements, and management reports. In addition, the Accounting Directive requires the publication and disclosure of the required information and the audit of financial statements. With respect to small- and medium-sized enterprises, the Member States may apply optional exemptions to the regulatory requirements of the Accounting Directive to avoid excessive demands for those undertakings. The laws and provisions necessary to comply with the Accounting Directive must be effective as of July 20, 2015.[135]

In addition, another directive requires large groups to report non-financial and diversity information. The affected companies will be obligated to publish information providing an understanding of the undertaking's development, performance, and position, the impact of its activity on environmental, social, and employee matters, and its respect for human rights and handling of anti-corruption and anti-bribery matters. The Member States were required to transfer these provisions into domestic law by December 6, 2016.[136]

---

133 Prospectus Regulation, *supra* note 130, art. 3.

134 Council Directive 2013/34/E.U. on the Annual Financial Statements, Consolidated Financial Statements, and Related Reports of Certain Types of Undertakings, 2013 O.J. L 182/19 [hereinafter the "Accounting Directive"].

135 *Id.,* art. 53, §1.

136 See art. 4, §1 of Council Directive 2014/95/E.U. on the Disclosure of Non-Financial and Diversity Information by

C. Anti-Abuse and Tax Avoidance Measures

i. General Anti-Abuse Doctrine Under E.U. Law

In two decisions,[137] the E.C.J. dealt with situations in which the abusive use of the Parent-Subsidiary Directive and the Interest and Royalties Directive was at issue.

The joined cases regarding the abusive use of the Interest and Royalties Directive[138] had essentially the same, or a similar, fact pattern. Private equity funds ("A") based outside the E.U. held shares in an E.U.-based (Danish) group of companies through intermediary holding companies that were based in another E.U. Member State (Luxemburg or Sweden). The E.U.-based intermediary holding companies granted interest-bearing loans to the Danish companies. The Danish debtor companies requested an exemption from Danish withholding tax for interest payments made to the E.U. intermediary holding companies based on the place of residence of the intermediary holding companies in a Member State of the E.U. The exemption request was based on the Interest and Royalties Directive, whose benefits are available solely to E.U.-based companies. The Danish tax authorities denied the exemption on the grounds that the intermediate holding companies were not the beneficial owners of the interest income, but rather their non-E.U. owners, and that the insertion of the intermediate holding companies with little substance constituted an abusive practice designed to

Certain Large Undertakings and Groups, 2014 O.J. L 330/1, which amends the Accounting Directive.

137 *N Luxembourg 1 v. Skatteministeriet*, Joined Cases C-115, C-118, C-119 & C-299/16, [2019] ECLI:EU:C:2019:134; *Skatteministeriet v. T Danmark und Y Denmark Aps*, Joined Cases C-116/16 & C-117/16, [2019] ECLI:EU:C:2019:135.

138 Council Directive 2003/49/E.C. on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, 2003 O.J. L 157/49.

artificially create the conditions for obtaining a tax benefit under E.U. law.

This back-to-back lending arrangement was designed to achieve a reduction in withholding taxes under the Interest and Royalties Directive. The companies ultimately receiving the interest payments did not qualify for the elimination of withholding tax imposed by the E.U. Member State that was the place of residence of the ultimate borrower (Denmark). Hence, a two-legged arrangement was entered, in which the first leg of the back-to-back arrangement was the loan to the intermediary entities and the second leg was the loan to the Danish ultimate borrowers.

In its response to the various questions submitted by the Danish tax court in a request for a preliminary ruling on the interpretation of E.U. law, the E.C.J. held that the exemption from withholding tax on interest payments is restricted to the beneficial owner of the interest. The beneficial owner is the entity that actually benefits economically from the interest payment. To be the beneficial owner, the second lender in a two-legged transaction must have the power to freely determine the use to which the interest payment is put. The O.E.C.D. Commentaries to the Model Convention can be used to provide guidance on beneficial ownership for purposes of applying the beneficial ownership standard.

Moreover, applying general principles of E.U. law, the Interest and Royalties Directive cannot be relied upon as support for abusive and fraudulent ends. National courts and authorities are to refuse a taxpayer a benefit granted under E.U. law even if there are no domestic law or agreement-based provisions providing for such a refusal. Proof of an abusive practice requires a combination of (i) objective circumstances in which the purpose of those rules has not been achieved (despite their formal observance) and (ii) a subjective element consisting in the intention to obtain an advantage from the E.U. rules by artificially creating a fact pattern that suggests the conditions are met for obtaining the benefit. The presence of certain indications may demonstrate that an abuse of law exists. These include (i) the existence of a conduit company that is without economic justification and (ii) the purely formal nature of the structure of the group of companies, the financial arrangements, and the loans.

As a final point, the E.C.J. looked at one of the structures in which A was a collective investment entity based in Luxembourg that benefitted from favorable tax treatment as a *Société d'Investissement en Capital à Risque* or S.I.C.A.R. A S.I.C.A.R. is a company with share capital and in principle is subject to Luxembourg corporate income tax and municipal business tax at ordinary rates. However, dividends and interest on risk capital derived by a S.I.C.A.R. is specifically exempt from tax in its hands. Similar tax rules apply to Reserved Alternative Investment Funds known as R.A.I.F.'s. The E.C.J. concluded that a S.I.C.A.R. cannot benefit from the Interest and Royalties Directive with regard to interest income that is exempt from tax in its hands.

The E.C.J. affirmed this principle in several cases regarding the Parent-Subsidiary Directive.[139] These cases concerned holding companies of E.U. Member States receiving dividends from their Danish subsidiaries and distributing them through other intermediary companies to investment funds and their shareholders. In these cases, the granting of benefits of the Parent-Subsidiary Directive to the holding companies was in issue. The E.C.J. ruled that the Parent-Subsidiary Directive cannot be applied in an improper or abusive fact pattern. A Member State is obligated to apply anti-abuse rules of its tax conventions and the O.E.C.D. Commentary to prevent abuse where national law contains no anti-abuse provision applicable to a particular transaction.

However, in a decision dealing with the German anti-treaty shopping legislation and directive rules regarding relief from dividend withholding taxes, the E.C.J.[140] ruled that a domestic anti-abuse provision[141] infringes upon the anti-abuse provision found in Article 2(1) of the E.U. Parent-Subsidiary Directive and the fundamental freedoms of E.U. law. The German law provided that an irrefutable presumption of abuse exists when certain facts are

---

139 *Id.*

140 *Deister -Holding AG and Juhler Holding* A/-S, Joined Cases C-504/16 & C-613/16, ECLI:EU:C:2017:1009.

141 Section 50d(3) of the German Income Tax Act in the version of the Annual Tax Act 2007.

present. Consequently, no obligation is imposed on the tax authorities to provide even *prima facie* evidence of fraud or abuse. Consequently, it was not possible for the applicant to refute the allegation of abuse by factual evidence to the contrary. In the view of the E.C.J., in order to determine whether abuse is present, the structure must be examined on a case-by-case basis, with an overall assessment based on factors such as the organizational, economic, or other substantial features of the group of companies to which the parent company belongs and the structures and strategies of that group.

ii. <u>Legislative Measures</u>

In January 2016, the European Commission adopted an Anti-Tax Avoidance Package as part of its agenda for fair corporate taxation in Europe. The package contains concrete measures to "prevent aggressive tax planning, boost tax transparency and create a level playing field for all businesses in the E.U."[142] One key element of this package is the Anti-Tax Avoidance Directive ("A.T.A.D. 1"). It introduces five legally binding anti-abuse measures that all Member States should apply against common forms of aggressive tax planning until December 31, 2018.[143] Its scope was expanded by

---

[142] The key elements of the Anti-Tax Avoidance Package are (i) the Chapeau Communication, (ii) the Anti-Tax Avoidance Directive, (iii) the Administrative Cooperation Directive, (iv) the Recommendation on Tax Treaties, (v) the Communication on an External Strategy for Effective Taxation, and (vi) the Study on Aggressive Tax Planning; "Anti-Tax Avoidance Package." European Commission Taxation and Customs Union. January 2016. http://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package_en, c.f., Commission Communication to the European Parliament and the Council on the Anti-Tax Avoidance Package, COM (2016) 23 Final (Jan. 2016).

[143] Council Directive 2016/1164/E.U. Laying Down Rules Against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, 2016 O.J. L 193/1 [A.T.A.D. I], amended by Council Directive 2017/952/E.U.

A.T.A.D. 2 with regard to Hybrid Mismatches with Third Countries. A.T.A.D. 2 had to be implemented by the Member States until December 31, 2019.

The Directive applies to all taxpayers that are subject to corporate tax in one or more Member States, including permanent establishments Member States of entities resident for tax purposes in a third country.[144]

a. <u>General Interest Limitation Rule</u>

Under the general interest limitation rule, borrowing costs will be deducted to the extent that the taxpayer receives interest or other taxable revenues from financial assets. The deduction of any exceeding borrowing costs will be limited to an amount of 30% of the taxpayer's earnings before interest, taxes, depreciation, and amortization or €3 million, whichever is higher.[145] The limitation applies without distinction as to the origin of the debt (*e.g.*, it is irrelevant whether the interest is related to intragroup, third-party, E.U., or third-country debt, or whether the lender is effectively taxed on such interest).

Member States have the option to introduce an override if a taxpayer can demonstrate that its ratio of equity to total assets is no more than two percentage points lower than the equivalent group ratio. An additional exception is allowed in cases where excessive borrowing costs are incurred on third-party loans used to fund certain public infrastructure projects. Borrowing costs that cannot be deducted in the current tax year can be carried forward into subsequent tax years without limitation, or can be carried back for three years. Excess interest capacity in any year can be carried forward for five years. Member States can postpone the implementation of the interest expense limitation rule, provided a national rule is in place

---

on Hybrid Mismatches with Third Countries, 2017 O.J. L 144/1 [hereinafter "A.T.A.D. II"].

144 *Id.,* Article 1 §2.

145 This provision on the interest limitation rule is similar to the current German interest limitation rule.

preventing base erosion and profit shifting that provides a comparable result. The deferred implementation date cannot be later than January 1, 2024, and may be advanced in the event of an earlier implementation date in the comparable O.E.C.D. provision under the B.E.P.S. Action Plan.

b. Exit Taxation

The provision on exit taxation obliges Member States to apply an exit tax when a taxpayer relocates its assets or tax residence. Examples of this include a taxpayer that falls into any of the following fact patterns:

- It transfers assets from its head office to its permanent establishment in another Member State or in a third country.

- It transfers assets from its permanent establishment in a Member State to its head office or another permanent establishment in another Member State or in a third country.

- It transfers its tax residence to another Member State or to a third country, except for those assets which remain effectively connected with a permanent establishment in the first Member State.

- It transfers its permanent establishment out of a Member State.

A taxpayer may pay these exit taxes in installments over at least five years for transfers within the E.U. or the E.E.A.[146] Regarding a transfer involving an E.E.A. state, that state must have concluded an agreement on mutual assistance for the recovery of claims that complies with Council Directive 2010/24/E.U.[147]

---

146 A.T.A.D. *supra* note 143, art. 5.

147 Council Directive 2010/24/E.U. Concerning Mutual Assistance for the Recovery of Claims Relating to Taxes, Duties, and Other Measures, 2010 O.J. L 84/1.

c. General Anti-Abuse Rule

Under the general anti-abuse rule ("G.A.A.R."), arrangements that are not put into place for valid commercial reasons reflecting economic reality, but are instead put into place for the main purpose (or one of the main purposes) of obtaining a tax advantage that defeats the object or purpose of an otherwise applicable tax provision will be ignored for the purposes of calculating the corporate tax liability. The tax liability will be calculated based on the definition of economic substance in accordance with relevant national law. G.A.A.R. is applicable to domestic as well as cross-border transactions.

d. Controlled Foreign Corporation Rules

The controlled foreign company ("C.F.C.") rules re-attribute the income of a low-taxed C.F.C. to its parent company. This is achieved by adding the undistributed income of an entity to the tax base of a taxpayer in the following cases:

- The taxpayer (together with its associated enterprises) holds (directly or indirectly) more than 50% of the voting rights or capital, or is entitled to receive more than 50% of the profits.
- Under the general regime in the country of the entity, profits are subject to an effective corporate tax rate lower than 50% of the effective tax rate that would have been charged under the applicable corporate tax system in the Member State of the taxpayer.
- More than one-third of the income of the entity comes from
    - interest or any other income generated by financial assets;
    - royalties or any other income generated from intellectual property or tradable permits;
    - dividends and income from the disposal of shares;

    - financial leasing;
    - immovable property, unless the Member State of the taxpayer would not have been entitled to tax the income under an agreement concluded with a third country;
    - insurance, banking, and other financial activities; or
    - services rendered to the taxpayer or its associated enterprises.
- The entity is not a company whose principal class of shares is regularly traded on one or more recognized stock exchanges.

Undistributed income of a C.F.C. is included in a taxpayer's home country income. According to the E.U. Directive, Member States are allowed to adopt one of two approaches for computing the inclusion:

- The tainted undistributed income listed above is fully included in a shareholder's income, subject to an exception for the undistributed income of a C.F.C. that carries on a substantive economic activity supported by staff, equipment, assets, and premises. Members exclude this active business exception if the C.F.C. is not a resident of an E.U. Member State or an E.E.A. State.

- All undistributed income from non-genuine arrangements are included in a shareholder's income if obtaining a tax advantage is an essential purpose of the arrangement. Germany, for instance, has apparently opted for this slightly stricter approach.

Whether an arrangement is non-genuine is determined by reference to the staffing and performance of persons assigned to the C.F.C. or by the persons of the controlling company. The income to be included is based on the value of the functions performed by the staff of the controlling company. A *de minimis* rule applies so that companies with accounting profits that do not exceed 10% of the total income of the controlled company, provided that such amount does not exceed €80,000, are not covered by the C.F.C. rule.

e. Hybrid Mismatches

A hybrid mismatch results from two jurisdictions giving different legal characterization to a business form – *viz*., whether a permanent establishment exists – or a business transaction – *viz*., whether a payment is deductible interest or dividends paid on a participation. This may lead to a situation where

- a deduction of the same payment, expenses, or losses occurs both in the jurisdiction in which the payment has its source, the expenses are incurred, or the losses are suffered, and in another jurisdiction (double deduction);

- a deduction of a payment occurs in the jurisdiction in which the payment has its source without a corresponding inclusion of the same payment in another jurisdiction (deduction without inclusion); or

- no taxation occurs on income in its source jurisdiction without inclusion in another jurisdiction (no taxation without inclusion).

Where a double deduction exists between two Member States, a deduction will be allowed only in the Member State where the payment has its source. In relation to third countries, the Member State generally denies the deduction. Where there is a deduction without inclusion between two Member States, no deduction will be allowed. In relation to third countries, the Member State denies the deduction if it is the source jurisdiction, and, generally, it includes the payment in its tax base if the third country is the source jurisdiction. Where nontaxation without inclusion exists, the jurisdiction where the business is resident includes the income in its tax base.

In respect of its territorial scope, A.T.A.D. 1 was limited to hybrid mismatches that arise in interaction between two Member States. Provisions concerning hybrid mismatches involving third countries were not included. In order to fix this insufficient territorial scope, the E.U. Council adopted A.T.A.D. 2,[148] which aims at neutralizing also tax effects from hybrid mismatches involving third countries, consistent with the recommendations outlined in the O.E.C.D. B.E.P.S. Report on Action 2.[149]

In addition to the broadening of the territorial scope, the amended provisions[150] now also address further types of hybrid mismatches which were not yet covered by the anti-tax avoidance measures in A.T.A.D. 1. The rules on hybrid mismatches are divided into three provisions as follows:

- **Hybrid Mismatches:**[151] Article 9 already existed under A.T.A.D. 1, the amended version now acts as a catch-all element tying on the broadly defined terms "hybrid mismatch" and "hybrid transfer." In comparison to the original scope the provision additionally covers the following structures:

    - **Hybrid Permanent Establishment Mismatches:** Two jurisdictions differ on whether a business activity is being carried out through a permanent establishment.

    - **Hybrid Transfers:** Two jurisdictions differ on whether the transferor or the transferee of a financial instrument has the ownership of the payments on the underlying asset.

---

148 Council Directive 2017/952/E.U. on Hybrid Mismatches with Third Countries, 2017 O.J. L 144/1.

149 O.E.C.D. (2015), *Neutralizing the Effects of Hybrid Mismatch Arrangements*, *Action 2 2015 Final Report*, O.E.C.D./G-20 Base Erosion and Profit Shifting Project, O.E.C.D., Paris.

150 Council Directive 2016/1164/E.U. as amended by Council Directive 2017/952/E.U., art. 9a, 9b.

151 *Id.,* art. 9.

- **Imported Mismatches:** The effect of a hybrid mismatch between parties in third countries is shifted into the jurisdiction of a Member State through the use of a non-hybrid instrument thereby undermining the effectiveness of the rules that neutralize hybrid mismatches.

- **Reverse Hybrid Mismatches:**[152] Reverse hybrid mismatch structures occur where an entity is incorporated or established in a Member State that qualifies the entity as transparent and a direct or indirect interest in 50% or more of the voting rights, capital interest or rights to a share of profit is held in aggregate by one or more associated nonresident entities located in a third country that regards the entity as non-transparent. Pursuant to Article 9a(1) the hybrid entity shall be regarded as a resident of that Member State and taxed on its income to the extent that that income is not otherwise taxed under the laws of the Member State or any other jurisdiction. This provision shall not apply to a collective investment vehicle, *i.e.*, an investment fund or vehicle that is widely held, holds a diversified portfolio of securities and is subject to investor-protection regulation in the country in which it is established.[153]

- **Tax Residency Mismatches:**[154] The taxpayer is resident for tax purposes in two (or more) jurisdictions. A deduction for payment, expenses or losses from the tax base of this taxpayer is possible in both jurisdictions. Article 9b directs the Member State of the taxpayer to deny the deduction to the extent that the other jurisdiction allows the duplicate deduction to be set off against income that is not dual-inclusion income. If both jurisdictions are Member States, the Member States where the taxpayer is not deemed to be

---

152 *Id.,* art. 9a. Article 9a also applies to all entities that are treated as transparent for tax purposes by a Member State.

153 *Id.,* art. 9a §2.

154 *Id.,* art. 9b.

a resident according to the D.T.C. between the two Member States concerned shall deny the deduction.

Member States are required to adopt the A.T.A.D. 2 into their domestic tax law by January 1, 2020, and, in respect of the reverse hybrid mismatch rules, by January 1, 2022.

f. Withholding Tax Procedures

On December 10, 2024, the Council adopted new rules on faster and safer relief of excess withholding taxes, amending Directives 2009/102/E.C. and 2017/1132/E.U. (the "F.A.S.T.E.R. Directive").[155] Member States will have to transpose the F.A.S.T.E.R. Directive into their national law by December 31, 2028, with the national legislation applying from January 1, 2030.

The F.A.S.T.E.R. Directive aims to expedite by aligning the withholding tax relief and refund procedures of all 27 Member States while ensuring transparency and certainty with regard to the identity of investors for securities issuers, withholding tax agents, financial intermediaries, and Member States. The F.A.S.T.E.R. Directive introduces three measures to make the relief and refund procedures more efficient: a common tax residence certificate, fast-track procedures, and reporting obligations.

- **The Common Tax Residence Certificate ("T.R.C."):** The T.R.C. will be issued for up to one fiscal year and only one T.R.C. will be required to claim multiple refunds during the same calendar year. Member States will recognize an T.R.C. issued by another Member State as adequate proof of a cross-border investor's residence in that other Member State.

- **Fast-Track Procedures:** The F.A.S.T.E.R. Directive introduces two fast-track procedures complementing the

[155] Council Directive 2025/50 on faster and safer relief of excess withholding taxes of December 10, 2024.

existing standard refund procedure in E.U. Member States from which the Member States will be able to choose:

- Relief-at-source where the relevant tax rate based on an applicable tax treaty is applied at the time the dividends or interest are paid

- A quick refund procedure where the reimbursement of excess withholding tax will be granted within 60 days upon receipt of the refund request

Standardized reporting for financial intermediaries is designed to facilitate the detection of potential tax fraud or abuse. Intermediaries will need to submit transaction information to the tax authorities of the source country. This should enable a tracing of the relevant cross-border investors (so-called direct reporting). In the case of securities payments, each of the intermediaries along the securities payment chain will be required to report the information on the transaction (so-called indirect reporting). Among information to be submitted by the intermediaries are the cross-border investor's T.R.C., a declaration that the investor is entitled to the relief, and, if required by the source country, that the investor is the beneficial owner based on national legislation or an applicable tax treaty. This information has to be obtained as part of K.Y.C. procedures. They will have to maintain the supporting documentation of the reported information for ten years.

g. Proposed "Unshell" Directive

On December 22, 2021, the E.U. Commission published a proposal for a directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/E.U. (the "Unshell Directive," or A.T.A.D. 3).[156] On January 17, 2023, the European Parliament approved the European Commission's proposal, as amended by the Committee on Economic and Monetary

[156] E.U. Commission Communication COM (2021) 565 final (December 2021).

Affairs ("E.C.O.N.").[157] The key element of the proposal is a threefold substance test to assess whether an entity will be deemed a shell company. The principles of this substance test are as follows:

- In the first step, an entity will fail substance requirements if more than 65% of its income consists of income from financial assets, intellectual or intangible property, dividends and capital gains from shares, or other categories of income from specific outsourced activities.

- An entity will fail the second step of the test if at least 55% of its income is received through transactions involving more than one jurisdiction or passed on to entities that are not resident in the same jurisdiction as the entity under review.

- The third and final step will be failed if the entity has outsourced its administration of day-to-day operations and decision-making on significant functions within the last two tax years.

If the entity is deemed to be a shell company, it will need to declare a minimum level of substance in the Member State of its tax residence. Otherwise, the company will lose the protection of double taxation agreements between its Member State and other Member States of the E.U., as well as any tax relief based on E.U. Directives.

h. Proposed "DEBRA" Directive

As a further amendment to the communication on B.E.F.I.T.,[158] on May 11, 2022, the E.U. Commission tabled a proposal for a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes (the "DEBRA

---

[157] European Parliament legislative resolution of January 17, 2023, on the COM (2021) 565 Final.

[158] See Section 4.B.ii, above.

Directive").[159] The European Parliament approved the Commission's proposal with certain amendments.[160] The directive addresses the predominate use of debt rather than equity for financing investments. This is sometimes favored due to an asymmetry in tax treatment, since tax systems in the E.U. allow the deduction of interest payments on debt when calculating the tax base for corporate income tax purposes, while costs related to equity financing, such as dividends, are mostly not tax deductible. Therefore, to reduce tax-induced debt-equity bias, the directive lays down rules to allow the deduction for tax purposes of notional interest on increases in equity, and to limit the tax deductibility of exceeding borrowing costs. The new rules shall apply to all taxpayers subject to corporate tax in one or more E.U. Member States, except for financial undertakings. It has been proposed for small- and medium-sized enterprises to get a higher notional interest rate, due to the typically higher burdens they face to obtain financing.

D. Simplification of European Tax Law

In recent years, the E.U. has also sought to reduce compliance costs and simplify the European tax system.

On July 15, 2020, the Commission set out an action plan for fair and simple taxation (the "Simple Taxation Action Plan").[161] Since that time, the Commission has presented a series of concrete proposals designed to simplify European tax law and reduce compliance costs. For instance, the B.E.F.I.T Proposal was introduced with the

---

159 Commission Proposal for a Council Directive on a debt-equity bias reduction, COM (2022) 216 Final (May 2022).

160 European Parliament legislative resolution of January 16, 2024, on the COM (2022) 216 Final (May 2022), T.A./2024/0006.

161 Commission Communication, COM (2020) 312 Final (July 2020).

intention of reducing compliance costs.[162] The proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes[163] also aims to reduce compliance costs.[164] For small and medium-sized enterprises, the Commission has proposed the introduction of a head office tax system.[165] Its primary objective is to reduce compliance costs for small and medium-sized enterprises.[166]

E. <u>Conclusion</u>

It is clear that over recent years, the major economic democracies in Europe have attempted to retake control of their tax borders by forcing companies resident in E.U. Member States, and the E.U. Member States themselves, to operate in a totally transparent environment. By shining a light on tax planning and rulings, the European Commission hopes to obtain a level playing field for all Member States regarding tax policy. While these steps do not amount to a common set of tax rules that will apply across Europe, they will likely reduce the opportunities for taxpayers to gain benefits through divergent tax treatment in two or more jurisdictions.

---

162 COM (2023) 532 Final, No. 1 "Reasons for and objectives of the proposal."

163 COM (2023) 324 Final.

164 *Id.*, No. 2 second Point "Subsidiarity."

165 COM (2023/320) Final.

166 *Id.*, No. 1.

5. Luxembourg[1]

Over the last few decades, Luxembourg has been extremely popular as a holding and financing jurisdiction for both E.U. and non-E.U. investors, as well as an attractive location for collective investment funds and their managers. Its position as an important financial center, and the professional environment it offers, combined with attractive tax treatment and corporate flexibilities, give Luxembourg a leading role worldwide in investment funds and as a preferred European jurisdiction for holding, financing, and private wealth management activities.

Under Luxembourg law, a variety of legal forms and fund regimes are available and suitable for holding, financing, and investment activities.

A taxable Luxembourg holding company, which in French is often referred to as a "*société de participations financières*" or a "S.O.P.A.R.F.I.," is an attractive vehicle to serve as a group holding company or investment platform. A S.O.P.A.R.F.I. is a normal commercial company that may carry out any activities falling within the scope of its corporate purpose clause. A S.O.P.A.R.F.I. may take the form of, *inter alia*, a *société anonyme* ("S.A.," a public limited company), a *société à responsabilité limitée* ("S.à.r.l.," a limited liability company), or a *société en commandite par actions* ("S.C.A.," a partnership limited by shares). As a company having share capital, a S.O.P.A.R.F.I. is fully subject to Luxembourg income tax and net worth tax. Profit distributions by a S.O.P.A.R.F.I. are, in principle, subject to a 15% Luxembourg dividend withholding tax. A S.O.PA.R.F.I. generally is, entitled to the benefits

---

[1] This chapter of the article was written by Rutger Zaal of AKD Luxembourg, based in part on material originally prepared by Frank van Kuijk of Loyens & Loeff, New York. The author acknowledges the contribution of his colleague Sanja Vasic, also of AKD Luxembourg, in the preparation of this section.

of the tax treaties concluded between Luxembourg and other countries and the E.U. tax directives.

Another attractive investment vehicle is a private wealth management company - *société de gestion de patrimoine familial regime* ("S.P.F."). In contrast to the S.O.P.A.R.F.I., an S.P.F. is fully exempt from Luxembourg corporate income, net worth, and withholding taxes but is neither eligible for protection under the Luxembourg bilateral tax treaties nor covered by the E.U. tax directives.

Luxembourg law further provides for several collective investment vehicles. One regime applies to investments in risk-bearing capital (*e.g.*, venture capital and private equity), namely the *société d'investissements en capital à risque* ("S.I.C.A.R."). A second regime applies to specialized investment funds ("S.I.F."). This regime is designed for well-informed investors. A third regime applies to reserved alternative investment funds ("R.A.I.F."). It provides lighter establishment guidelines and more flexible corporate and operating regulations fitting the needs of alternative investment fund ("A.I.F.") managers and investors. A fourth regime provides a legal and regulatory framework for securitization vehicles ("*sociétés de titrisation*") coupled with a favorable tax regime. The S.I.C.A.R., the S.I.F., the R.A.I.F., and the securitization vehicle will be discussed in Sections 5.M, 5.N, 5.O, and 5.P, respectively, below. In addition, Luxembourg non-regulated funds are often set up under the form of a Luxembourg (special) limited partnerships or "*société en commandite (spéciale).*"

A. General

i. Income Tax

A S.O.P.A.R.F.I. established in the city of Luxembourg is subject to Luxembourg income tax at a combined top rate of 23.87%. This rate includes the 16% national corporation income tax ("C.I.T."), plus the 6.75% Luxembourg City municipal business tax ("M.B.T."), and a 7% unemployment fund surcharge.

ii. Capital Duty

Luxembourg has no capital duty. Instead, a fixed registration duty of €75 applies to (i) the incorporation of a Luxembourg entity, (ii) an amendment to the bylaws of a Luxembourg entity, and (iii) the transfer of the statutory or actual seat of an entity to Luxembourg.

iii. Annual Net Worth Tax

A S.O.P.A.R.F.I. is subject to an annual net worth tax, which is levied at the rate of 0.5% of the company's worldwide net worth on January 1 of each year, evaluated on the basis of the company's balance sheet as of December 31 of the preceding year. A reduced rate of 0.05% applies for taxable net wealth in excess of €500 million.

Certain assets are excluded, such as shares in a participation, provided that the participation exemption for dividend income is applicable, as described in Section 5.B below. Note, however, that there is no minimum holding period requirement with regard to the net worth tax exemption.

Through fiscal year 2024, a fixed minimum net worth tax was applicable, set at €4,815 (including a 7% surcharge), based on the closing balance sheet of the preceding year, when the resident corporate taxpayer's financial assets for the prior year exceeded 90% of its total balance sheet and the balance sheet total exceeded €350,000, which is the case for most holding and financing companies.[2] In all other cases, the minimum tax was contingent on the balance sheet total of the resident corporate taxpayer, varying

[2] In a decision of the Luxembourg Constitutional Court from November 10, 2023 (185/23), the unconstitutionality of this provision of the law has been confirmed. Pending amendments to the law, the taxpayers whose balance sheet total is between €350,000 and €2 million, previously subject to the €4,815 minimum net wealth tax will be subject to a minimum net wealth of €1,605. A draft bill (number 8388) has been presented before the Luxembourg Parliament, further explained in Section 5.Q.

from €535 to €32,100, the latter maximum applying in case of a balance sheet total exceeding €30 million.

As of fiscal year 2025, the minimum net worth tax is determined on the basis of a company's total balance sheet without any additional criteria. A company with a balance sheet total of up to €350,000 will be subject to a minimum net worth tax of €535, a company with a balance sheet total of more than €350,000 but less than €2 million will be subject to minimum net worth tax of €1,605, and a company with a balance sheet total of more than €2 million will be subject to minimum net worth tax of €4,815. If a S.O.P.A.R.F.I. is part of a Luxembourg fiscal unity, both the parent company and its subsidiaries that are part of the fiscal unity are subject to the net wealth tax, including the minimum amount. However, the aggregate minimum tax payable by a fiscal unity is capped at €32,100. Each member of the fiscal unity is fully liable for its own tax and the tax of its subsidiaries within the fiscal unity, including interest and penalties for late tax payments.

Subject to certain conditions, a S.O.P.A.R.F.I can credit part of its preceding year C.I.T. against the net worth tax of a given year. The S.O.P.A.R.F.I must create a non-distributable reserve of five times the amount of the credit it is seeking and must retain the reserve for at least five years.

iv. <u>C.F.C.</u>

As far as the C.F.C. legislation is concerned, Luxembourg implemented option B, as set out in A.T.A.D. (as defined below) which provides that where a C.F.C. has been put in place for the purpose of obtaining a tax advantage, Luxembourg corporate taxpayers will be subject to C.I.T. on the undistributed net income of a C.F.C., *pro rata* to their ownership or control of the foreign branch or the indirectly-held subsidiary, but only to the extent such income is related to significant functions carried out by the Luxembourg corporate taxpayer. To the extent that a Luxembourg company can establish that it does not perform significant functions related to the C.F.C.'s activities, the C.F.C. rules should not have an adverse tax impact.

v. **Hybrid Mismatch Rules and Reverse Hybrid Mismatch Rules**

Hybrid mismatch rules introduced on the basis of A.T.A.D.[3] seek to prevent mismatch outcomes that arise as a consequence of the hybrid nature of a financial instrument, legal entity, or permanent establishment ("P.E."). Targeted mismatch outcomes are deduction non-inclusion, double deduction, and double nontaxation outcomes. The main concern in Luxembourg will be (i) the potential denial of deduction of a payment made under a hybrid instrument or made by/to a hybrid entity and (ii) the application of corporate income tax on all or part of the income of Luxembourg transparent entities.

For the "ordinary" hybrid rules to apply, the mismatch must arise between associated entities or as part of a structured arrangement. When a person acts together with another person with respect to the voting rights or capital ownership in an entity, their participations in the entity will be aggregated in order to determine whether they are "associated" with that entity.[4]

Upon request, taxpayers must provide the tax administration with relevant documentation reasonably proving the absence of a hybrid mismatch or that another country has already tackled the hybrid

---

3 Effective January 1, 2019, Luxembourg, implemented the Anti-Tax Avoidance Directive (2016/1164) ("A.T.A.D.") and Anti-Tax Avoidance Directive 2 (2017/952) ("A.T.A.D."). A.T.A.D. 1 and A.T.A.D. 2 form the E.U.-wide implementation of Action 2 of the O.E.C.D.'s work on base erosion and profit shifting ("B.E.P.S."), which called for rules to neutralize the effects of hybrid mismatch arrangements through deduction limitations and a general anti-abuse rule.

4 Luxembourg law provides that, in the absence of evidence to the contrary, an investor who directly or indirectly owns less than 10% of the interests in an investment fund and is entitled to less than 10% of the profits of the fund will not be considered as acting together with other investor(s) in the same fund.

mismatch. Relevant documents include tax returns and certificates from foreign tax authorities.

B. Participation Exemption

A S.O.P.A.R.F.I. may be entitled to the benefits of the Luxembourg participation exemption, which grants a 100% exemption for dividends and gains (including foreign exchange gains) realized from qualifying subsidiaries. The participation exemption also applies to dividends received and gains realized on participations that are attributed to a Luxembourg permanent establishment of a resident of (i) an E.U. Member State or (ii) a country in which it is subject to tax, as discussed in Section 5.C.

i. Dividends

According to Article 166 of the Luxembourg Income Tax Act ("I.T.A."), dividends (including liquidation proceeds) received by a S.O.P.A.R.F.I. are exempt from Luxembourg income tax if the following requirements are met:

The S.O.P.A.R.F.I. holds 10% or more of the issued share capital of the subsidiary (which may be held via a tax-transparent entity), or the participation has an acquisition cost of at least €1.2 million.

The subsidiary is (a) an entity falling within the scope of Article 2 of the E.U. Parent-Subsidiary Directive (2011/96/E.U.), as amended from time to time, (the "P.S.D.")[5] or a permanent establishment thereof, provided the hybrid loan provision and the general anti-abuse rule known as the "G.A.A.R." do not apply (please see below), (b) a fully taxable Luxembourg capital company having a legal form that is not listed in the annex to the P.S.D., or (c) a non-Luxembourg capital company subject in its country of residence to

[5] A company is covered by articled 2 of the P.S.D when it takes one of the forms listed in the Annex I to the P.S.D., is tax resident in a Member State, is not considered tax resident elsewhere, and is subject to tax without the possibility of an option to be exempt or actually being exempt.

a profit tax comparable to Luxembourg's C.I.T. in terms of rate and taxable basis (the "Comparable Tax Test"). See Section 5.C of this chapter, below, for further details.

At the time of distribution, the S.O.P.A.R.F.I. must have held, or must commit itself to continue to hold, the participation for an uninterrupted period of at least 12 months, and during this period, its interest in the subsidiary may not drop below the threshold mentioned above (10% or an acquisition cost of €1.2 million).

Regarding the second condition described in item (ii)(a) above, the Luxembourg participation exemption was amended in line with the revised P.S.D. and includes a provision countering hybrid loan arrangements and implementing the G.A.A.R. The hybrid loan provision aims at preventing double non-taxation via the use of hybrid financing arrangements by limiting the exemption of payments received through such arrangements if such payment is deducted in another E.U. Member State. The G.A.A.R. requires E.U. Member States to refrain from granting the benefits of the P.S.D. to certain arrangements that are not "genuine." For the arrangement to be non-genuine, one of its main purposes must be to obtain a tax advantage that would defeat the object or purpose of the P.S.D. Therefore, dividends received by a Luxembourg taxpayer from a subsidiary in the E.U. (including in principle Luxembourg subsidiaries) are not exempt if they are deductible by the E.U. subsidiary distributing the dividend. In addition, when the P.S.D.-based participation exemption is applied, the dividend arrangement must not violate the G.A.A.R. in order for the exemption to apply. The G.A.A.R. should not apply to distributions from a Luxembourg company to another Luxembourg company that is normally subject to tax.

The Luxembourg domestic participation exemption could be viewed as still being available notwithstanding the G.A.A.R. if the subsidiary meets the Comparable Tax Test referred to above, and further detailed in Section 5.C below, in the context of an income tax treaty, which should be the case for many E.U. Member State subsidiaries.

The participation exemption applies on a per-shareholding basis. Consequently, dividends from newly acquired shares will immediately qualify for the participation exemption provided that the rules above are met (10% or an acquisition value of €1.2 million).

Beginning with fiscal year 2025, Luxembourg S.O.P.A.R.F.I.'s may opt out of application of the participation exemption, as further explained in Section 5.Q.iii.

ii. Capital Gains

According to the Grand-Ducal Decree of December 21, 2001, as amended, regarding the application of Article 166 I.T.A., capital gains (including foreign exchange gains) realized by a S.O.P.A.R.F.I. upon the disposition of shares of a subsidiary are exempt from Luxembourg income tax if the following requirements are met:

- The S.O.P.A.R.F.I. holds 10% or more of the issued share capital of the subsidiary (which may be held via a tax-transparent entity), or the participation has an acquisition cost of at least €6 million.

- The subsidiary is (i) an entity falling within the scope of Article 2 of the P.S.D. or a permanent establishment thereof, (ii) a fully taxable Luxembourg capital company having a legal form that is not listed in the annex to the P.S.D., or (iii) a non-Luxembourg capital company meeting the Comparable Tax Test.

- The S.O.P.A.R.F.I. must have held, or must commit itself to continue to hold, a minimum participation, as mentioned above, for an uninterrupted period of at least 12 months.

The capital gains exemption is not subject to the G.A.A.R. as implemented in Luxembourg law following the amendments to the P.S.D., as the latter only relates to dividends and not capital gains.

C. Subject to Tax

As outlined above, in order to qualify for the Luxembourg participation exemption on dividends and capital gains, nonresident subsidiaries should either qualify under Article 2 of the P.S.D. or must be subject to a comparable tax in their country of residence, (" the Comparable Tax Test").

Based on parliamentary history, the Comparable Tax Test requires that the nonresident subsidiary (i) be subject to a tax rate of at least half the Luxembourg C.I.T. rate (*i.e.*, currently at least 8%) and (ii) be subject to tax on a basis that is determined in a manner comparable to the determination of the taxable basis in Luxembourg. It is not fully clear whether the Comparable Tax Test should be applied on the basis of an effective rate or tax base. Furthermore, no list of qualifying countries exists for this purpose. Where comparability is unclear, an advance tax agreement ("A.T.A.") can be requested from the Luxembourg tax authorities ("L.T.A.").

Beyond the domestic participation exemption, certain treaties concluded by Luxembourg contain a lower rate or a participation exemption for dividends, without a Comparable Tax Test being required. Therefore, by virtue of such treaties, dividends received from favorably taxed foreign companies, such as a Swiss finance company, should be exempt from tax at the S.O.P.A.R.F.I. level. In addition, the minimum ownership period requirement of a treaty is generally shorter than the period required under Luxembourg law (*e.g.*, the beginning of the accounting year versus 12 months). Application of these more favorable treaty provisions is subject to the Multilateral Instrument applying as discussed below in Section 5.H of this chapter of the article.

D. <u>Tax-Free Reorganizations</u>

The Luxembourg I.T.A. provides for certain reorganizations that are viewed as tax-free in the hands of shareholders of certain capital companies (*i.e.,* application of a roll-over). Included are (i) transformations of a capital company into another capital company whereby securities of the transformed company are issued to the shareholder, (ii) mergers or demergers of capital companies or companies resident in an E.U. Member State whereby securities of the merged company are issued to shareholders of the disappearing company, and (iii) certain share-for-share exchange transactions.

For the transaction to qualify as a tax-free reorganization, the acquisition date and cost basis of the transferred shares (or the book value of the converted loan in the first case above) must be carried over and continued in the financial statements to the shares received in exchange.

In the cases described above (other than the second), the transaction remains tax-free even if cash is paid to the shareholder, provided that the cash does not exceed 10% of the nominal value of the shares.

During the five years following the year in which one of the foregoing transactions occurs, income derived from a participation (*i.e.*, dividends and capital gains) received pursuant to the covered transaction does not fall within the scope of the participation exemption, if the transferred participation did not qualify for the participation exemption prior to the exchange transaction.

E. Exit Taxation

Luxembourg's exit tax payment deferral rules cover the transfer from or to Luxembourg of (i) corporate assets, (ii) corporate tax residence, and (iii) permanent establishments. In line with A.T.A.D. 1 and 2, a five-year payment deferral will apply to transfers to an E.U. or an E.E.A. jurisdiction.

No guarantee requirement or interest applies to the deferral. Exit tax payment deferrals granted for periods ending before January 1, 2020, are grandfathered.

Upon migration out of Luxembourg, the migrating company is deemed liquidated and its assets and liabilities will be realized at fair market value.

In the case of a transfer of assets to Luxembourg from an E.U. or non-E.U. jurisdiction, the tax book value of the assets transferred equals the value used by the exit state, except where that value does not reflect the fair market value of the assets.

F. Luxembourg Permanent Establishment

Under domestic law, and in absence of any tax treaty, profits of a P.E. of a Luxembourg-resident taxpayer are included in the taxable basis and a credit for underlying tax is available. Where a Luxembourg resident maintains a P.E. in another country, the relevant tax treaty generally provides for an exemption in Luxembourg for the profits of the P.E. However, the L.T.A. can challenge the application of the exemption of income allocable to a P.E. under an applicable tax treaty. The L.T.A. may ask for proof of existence of the P.E. from the treaty partner jurisdiction. Such proof is mandatory if (i) the tax treaty does not have a clause that allows Luxembourg to deny the exemption under the applicable treaty and (ii) the other treaty partner does not impose tax on the income. Administrative guidance from the L.T.A. makes it clear that the absence of such confirmation will result in the denial of the P.E. exemption. Obtaining such proof should be closely monitored.

G. Partial Participation Exemption

An interest of less than 10% in a subsidiary with an acquisition cost of less than €1.2 million and/or an interest in a subsidiary for which the 12-month holding period requirement is neither met, nor expected to be met, does not qualify for the participation exemption. In those fact patterns, dividend income may be eligible for a 50% exemption, provided that the dividends are distributed by (i) a fully taxable Luxembourg capital company, (ii) a capital company resident in a treaty country that imposes a profit tax comparable to the Luxembourg C.I.T., or (iii) a company resident in an E.U. Member State and falling within the scope of Article 2 of the P.S.D. The exemption applies to the net dividend income which corresponds to the dividend received minus costs related to the participation incurred in the same year.

H. Withholding Tax in a Foreign Subsidiary's Country

Dividends paid by a foreign subsidiary to a Luxembourg holding company and gains on alienation of shares may be subject to withholding tax or capital gains tax. Such taxes may be eliminated or reduced pursuant to the P.S.D. or a tax treaty concluded by Luxembourg and the foreign subsidiary's country of residence.

As of the date of this article, Luxembourg has 86 income tax treaties in force with the following jurisdictions:

Andorra	Germany	Malta	Slovenia
Armenia	Greece	Mauritius	South Africa
Austria	Guernsey	Mexico	South Korea
Azerbaijan	Hong Kong	Moldova	Spain
Bahrain	Hungary	Monaco	Sri Lanka
Barbados	Iceland	Morocco	Sweden
Belgium	India	Netherlands	Switzerland
Botswana	Indonesia	Norway	Taiwan
Brazil	Ireland	Panama	Tajikistan
Brunei	Isle of Man	Poland	Thailand
Bulgaria	Israel	Portugal	Trinidad & Tobago
Canada	Italy	Qatar	Tunisia
China	Japan	Romania	Turkey
Croatia	Jersey	Russia	Ukraine
Cyprus	Kazakhstan	Rwanda	U.A.E.
Czech Republic	Kosovo	San Marino	U.K.
Denmark	Laos	Saudi Arabia	U.S.A.
Estonia	Latvia	Senegal	Uruguay
Ethiopia	Liechtenstein	Serbia	Uzbekistan
Finland	Lithuania	Seychelles	Vietnam
France	N. Macedonia	Singapore	South Africa
Georgia	Malaysia	Slovakia	South Korea

Additionally, Luxembourg is in the process of negotiating 11 new income tax treaties, while seven are in the process of being signed and published.

Luxembourg signed the Multilateral Instrument on June 7, 2017. On February 14, 2019, the Luxembourg parliament adopted the law ratifying the Multilateral Instrument, and the O.E.C.D. was notified on April 9, 2019. Nearly all of Luxembourg's treaties are so-called covered tax agreements.

Apart from certain compulsory provisions tackling treaty abuse scenarios, such as an introduction of the principal purpose test ("P.P.T."), Luxembourg accepted only a few optional rules included in the Multilateral Instrument. Luxembourg has sought to limit the scope and impact of the Multilateral Instrument to the minimum standards required.

In particular, Luxembourg has chosen option A in relation to Article Item 5 (Application of Methods for the Elimination of Double Taxation) and the P.P.T. without applying the limitation on benefits clause in relation to Article Item 7 (Prevention of Treaty Abuse). Luxembourg will not apply Article Item 4 (Dual Resident Entities), Article Item 8 (Dividend Transfer Transactions), Article Item 9 ('Real Estate Rich' Company Clause), Article Item 10 (Anti-Abuse Rule for Permanent Establishments situated in Third Jurisdictions), Article Item 11 (Savings Clause), Article Item 12 (Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements), Article Item 14 (Splitting Up of Contracts), or Article Item 15 (Definition of a Closely Related Persons).

Based on the signatories and parties to the Multilateral Instrument, as of June 5, 2024, 71 tax treaties concluded by Luxembourg have been affected by the Multilateral Instrument and the Multilateral Instrument is now in effect in respect of those treaties.

I. Deduction of Costs

i. Value Adjustments

A S.O.P.A.R.F.I. may make deductible value adjustments for a participation. The deductions can be used to offset other income and may result in tax losses. Losses that were incurred prior to 2017 may be carried forward indefinitely while the carry-forward of losses incurred as of January 1, 2017, is limited to 17 years after the losses occurred. Carryback of losses is not allowed.

Value adjustment and other expenses linked to an exempt participation that have been deducted in prior years or in the year of the sale are recaptured. The capital gains exemption described in Section 5.B.ii above does not apply to the extent of the deducted amounts. As a result, capital gains arising from a disposition of shares may be taxable in part, but can be offset by available losses carried forward.

ii. Financial Costs

Financing expenses connected with qualifying participation are tax deductible to the extent that they exceed exempt income arising from the qualifying participation in a given year. To the extent deductible, the deduction can be used to offset other types of income but such expenses are subject to the recapture rule described above. In principle, expenses are allocated on an historic direct-tracing basis. Where direct tracing is not possible, expenses are allocated on a *pro rata* basis that looks to the relative value of each participation.

Realized currency gains and currency losses on loans obtained to finance the acquisition or further capitalization of subsidiaries are taxable or deductible. Therefore, currency exposure should be avoided, preferably by denominating such loans in the currency that the Luxembourg taxpayer applies as its functional currency for tax reporting purposes. Currency gains on the investment in the participation itself and, in principle, on repayments of capital, are exempt under the participation exemption. Unrealized currency losses on the investment and on repayments of capital are deductible but may cause the recapture rules to apply in a subsequent period.

The interest deduction limitation rules cap deductions for "excessive borrowing costs" at the higher of 30% of the E.B.I.T.D.A. or €3 million. This refers to the excess, if any, of a Luxembourg taxpayer's deductible interest and economically equivalent expenses over its taxable interest income and economically equivalent income. Luxembourg companies that are part of a fiscal unity apply the interest deduction limitation rules at the level of the parent company of the group, unless a request is made for application at individual entity level.

The following three categories of Luxembourg taxpayers, *inter alia*, are excluded altogether from the application of the interest deduction limitation rules:

- A taxpayer that is a financial undertaking which is, *inter alia,* the case if the taxpayer is an A.I.F or a securitization vehicle in the sense of the E.U. regulation 2017/2402[6]

- A taxpayer that qualifies as a Standalone Entity, which means a taxpayer that is not part of a consolidated group for financial accounting purposes and has neither an Associated Enterprise nor a permanent establishment in another jurisdiction. An Associated Enterprise means (i) an entity (capital company, partnership, etc.) in which the taxpayer holds directly or indirectly 25% or more of the voting rights or capital ownership or is entitled to receive 25% or more of its profits or (ii) an individual or collective undertaking (capital company, partnership, etc.) which holds directly or indirectly 25% or more of the voting rights or capital ownership of the taxpayer or is entitled to receive 25% or more of the profits of the taxpayer.

- A taxpayer that is (i) not a Standalone Entity and (ii) not part of a consolidated group for financial purposes if it can prove that the ratio of the entity's equity over its total assets is superior or equal to the same ratio of the group. This exemption is applicable upon request of the taxpayer and is subject to specific anti-abuse rules.

- A taxpayer that qualifies for the "Group Ratio Exclusion," which is the case if the following conditions are cumulatively met:

    - The taxpayer is a member of a consolidated group for financial accounting purposes.

---

6 The exemption for securitization vehicles is likely to be removed by the Luxembourg legislators pursuant to a pending bill, as a result of a letter of formal notice sent under scrutiny by the E.U. Commission on March 9, 2022. However, it has not been removed as of the date of this writing.

- The ratio of equity over total assets (the “Equity Ratio”) of the consolidated group does not exceed the Equity Ratio of the taxpayer by more than 2 percentage points (*e.g.,* if the Equity Ratio of the consolidated group is 10%, this condition is met as long as the taxpayer’s Equity Ratio is at least 8%).

- All assets and liabilities are valued using the same method as in the consolidated financial statements established in accordance with I.F.R.S. or the national financial reporting system of an E.U. Member State.

- The taxpayer has filed a request to benefit from the Group Ratio Exclusion.

Deductions claimed for interest and royalty payments accrued or paid by Luxembourg companies are disallowed when the recipient is resident in a blacklisted jurisdiction. The disallowance is allowed where the following conditions are met:

- The recipient of the payment, or its beneficial owner if different, is not a tax transparent entity.

- The recipient or its beneficial owner is a related enterprise.[7]

- The recipient or its beneficial owner is established in a jurisdiction which is included on the list of noncooperative tax jurisdictions.

The taxpayer’s deductions will not be disallowed if it proves that the transaction is motivated by valid business reasons reflecting economic reality.

---

7 The concept of related enterprises is consistent with adopted for transfer pricing concepts (*i.e.,* two entities that are participating in each other or in the same company through capital, control, or management).

The Luxembourg list of noncooperative tax jurisdictions is the E.U. blacklist. It is revisited only at each year end. Therefore, if a country is added during a year, it will first be included in the list only as of the beginning of the following year. If a country is added and subsequently removed from a list during a year, it will not be included in the list for the next following year. If a country is removed from the E.U. list, the removal will take effect from the date of publication of the removal by the E.U.

iii. Liquidation Losses

A loss realized upon liquidation of a participation is deductible.

J. Withholding Tax on Outbound Dividends and Capital Gains

i. Distributions on Shares

Distributions made on shares by a S.O.P.A.R.F.I. are subject to Luxembourg dividend withholding tax imposed at the rate of 15%, unless a domestic exemption or a reduced treaty rate applies (see below with respect to liquidation distributions). If certain conditions are met, Article 147 of the I.T.A. provides exemptions for dividend distributions from a Luxembourg company to one of the following entities:

- An entity falling within the scope of Article 2 of the P.S.D., or a permanent establishment thereof.
- A fully taxable Luxembourg capital company having a legal form that is not listed in the annex to the P.S.D.
- A Swiss-resident capital company that is subject to corporation tax in Switzerland without benefiting from an exemption.
- A company resident in a treaty country that meets the Comparable Tax Test as discussed in Section 5.C, above.

The exemption applies where the following two conditions apply. The first is that the dividend is paid to one of the abovementioned qualifying entities that holds 10% or more of the issued share capital of the Luxembourg company or the participation has an acquisition cost of at least €1.2 million. The second is that the qualifying entity has held, or commits itself to continue to hold, a minimum participation for an uninterrupted period of at least 12 months.[8]

Shareholders that are considered as transparent for Luxembourg tax purposes should be disregarded when determining whether the above conditions are met. Instead, the most immediate indirect shareholder that is not tax transparent should be regarded as owning the participation in the Luxembourg company.

In a manner that is similar to testing the application of the participation exemption discussed above in Section 5.B before an exemption from withholding tax on dividends is applied to an E.U.-resident corporation, the arrangement by which the S.O.P.A.R.F.I. is held must be tested under the European G.A.A.R. of the P.S.D. as implemented in Luxembourg law. An improper, noncommercial purpose for the holding may prevent the application of the exemption. For non-E.U. shareholders, no such test is applicable. In addition, the Luxembourg domestic withholding tax exemption may be available notwithstanding the G.A.A.R., if the shareholder meets the Comparable Tax Test referred to above and in Section 5.C, which should be the case in the context of an income tax treaty. It should also be available for shareholders that are entities resident in an E.U. Member State. In this respect, the potential impact of the Multilateral Instrument must be taken into account as discussed in Section 5.H of this chapter and recent case law of the E.C.J. discussed in Section 5.B.i.

ii. <u>Interest Payment on Straight and Hybrid Debt</u>

Arm's length interest payments to Luxembourg and non-Luxembourg residents are not subject to Luxembourg withholding tax. However, interest paid on certain profit-sharing bonds, and

[8] In recent practice, prior to the completion of the 12-month holding period, the L.T.A. may request that the fulfillment of this requirement be guaranteed by way of a commitment letter from the shareholder.

arguably, interest paid on loans when sharing in a company's overall profit, is subject to 15% withholding tax, unless a lower tax treaty rate applies.

iii. Capital Gains in Hands of Shareholders

Resident individual shareholders are taxable on the disposition of shares by way of sale or liquidation of a S.O.P.A.R.F.I. where (i) the disposition or total or partial liquidation produces a speculation gain because it takes place within six months of acquisition or (ii) the individual directly or indirectly owns a substantial interest in the S.O.P.A.R.F.I.

In very broad terms, a substantial interest exists if a shareholder, alone or together with certain close relatives, holds more than 10% of the shares in a Luxembourg company at any time during the five-year period preceding the disposition of the shares.

Nonresident shareholders who do not have a Luxembourg permanent establishment to which shares in a S.O.P.A.R.F.I. – and income or gain related to the shares – are attributed are subject to Luxembourg capital gains tax on the disposition of shares only when the shareholding is considered to be a substantial interest and (i) the disposition or liquidation gives rise to a speculation gain as previously defined or (ii) the shareholders have been Luxembourg-resident taxpayers for more than 15 years and have become non-Luxembourg resident taxpayers less than five years before the disposition or liquidation. Nonetheless, Luxembourg may not be entitled to tax this gain under provisions of an applicable income tax treaty.

K. Repurchase of Shares in a S.O.P.A.R.F.I.

A repurchase that is part of a redemption of shares in a S.O.P.A.R.F.I. should give rise to a capital gain that generally is not subject to Luxembourg dividend tax. However, a case dated 2017[9] held that the repurchase could be viewed in certain circumstances as a "simulated" dividend that is subject to dividend tax if no

[9] Administrative Court, March 3, 2017, no. 39193C.

exemption applies. Typically, this occurs when the repurchase price is not supported by valid economic principles or when the repurchase should be viewed as a fictional or simulated transaction intended to distribute profits to the shareholder.

The risk becomes remote when there is a redemption of all the shares held by the shareholder. In this fact pattern the repurchase is considered to be a capital gain, that is not subject to Luxembourg dividend tax (the "partial liquidation") by virtue of Article 101 of the I.T.A.

In addition, the repurchase and immediate subsequent cancellation of an entire class of shares from a shareholder owning several classes is considered a sale, triggering capital gains tax and therefore not subject to withholding tax to the extent the repurchase price does not exceed the fair value. Any excess of value would be treated as a hidden dividend distribution, subject to withholding tax. Recent codification of the long-standing practice regarding the tax treatment of the repurchase and subsequent cancelation of a class of shares is included in Section 1.Q.i.

L. <u>Other Tax Issues</u>

i. <u>Debt-to-Equity Ratio</u>

Luxembourg law does not contain any provisions regarding debt-to-equity ratios, other than the general arm's length principle. However, a debt-to-equity ratio of not more than 85:15 is generally required by the L.T.A. for the financing of qualifying participations. If a higher ratio is maintained, such as 90:10, a portion of the interest payments may be considered as a deemed dividend, which will not be deductible for Luxembourg corporation income tax purposes, and, depending on the case, a Luxembourg dividend withholding tax obligation may arise.

In addition, L.T.A. have published a Circular in transfer pricing matters which is discussed below in Section 5.L.ii. The circular requires intragroup financing companies to be funded with an appropriate amount of equity in order to have the financial capacity to assume the economic risks of loan investments, but does not specify what an appropriate amount of equity is or the process to determine whether equity is appropriate. Thus, the amount of equity to be contributed to a group financing company is a factual question that is determined on a case-by-case basis.

ii. Transfer Pricing Regulations

To strengthen the transparency of Luxembourg transfer pricing legislation, the arm's length principle has been codified in Article 56 of the I.T.A. as of January 1, 2015, and Article 56bis of the I.T.A. as of January 1, 2017. The wording of Article 56 of the I.T.A. is based on Article 9 of the O.E.C.D. Model Tax Convention. The legislation stipulates that upon the request of the tax authorities, the taxpayer is obliged to present relevant information underlying the transfer prices agreed by associated enterprises. Based on the literal wording of Article 56, some taxpayers have argued that Luxembourg companies should be allowed to deduct deemed interest expense on interest-free debt for C.I.T. and M.B.T. purposes. Not surprisingly, the argument was challenged by the European Commission ("the Commission") in the *Huhtamaki* case discussed below in Section 5.L.vii.

Article 56*bis* of the I.T.A. lays down the basic principles for a transfer pricing analysis. These principles are in line with the O.E.C.D. transfer pricing guidelines and Action 8 through 10 of the B.E.P.S. Action Plan.

On December 27, 2016, the L.T.A. published a Circular to Articles 56 and 56*bis* of the I.T.A., modifying the rules for Luxembourg companies engaged in intragroup financing activities. The Circular clarified the L.T.A.'s interpretation of provisions regarding intragroup financing activities. According to the Circular, intragroup financing activities comprise all interest-bearing lending to related companies that are funded with financial instruments from sources within or outside the group.

The guiding principles of the Circular are that intragroup financing companies must have the financial capacity to assume risks and the ability to control and manage such risks. With respect to the financial capacity, the previous circular generally considered a minimum amount of equity at risk equal to the lower of either 1% of the intragroup financing amount or €2 million to be adequate. The

Circular, however, states that the appropriate amount of equity at risk should be determined on a case-by-case basis. On the control and management of risk, the Circular refers to adequate people-related functions. The specific substance requirements are broadly similar to those outlined in the previous circular, which called for (i) key decisions being made in Luxembourg, (ii) control of the transactions being carried out by qualified personnel in Luxembourg, (iii) having Luxembourg residents comprise a majority of the board of directors, (iv) holding at least one annual shareholder meeting in Luxembourg, and (vi) ensuring that the Luxembourg company is not considered to be tax resident in any other jurisdiction.

In addition, the Circular requires that the lending company should have an understanding of all material risks that are undertaken.

The Circular provides for safe harbors in certain circumstances. An after-tax return on equity of 10% may reflect an arm's length compensation for financing and treasury functions for companies with a functional profile similar to that of a regulated financial undertaking. This percentage will be reviewed and updated regularly by the Luxembourg direct tax authorities. For intragroup financing companies performing pure intermediary activities, transactions will be considered arm's length where the Luxembourg company generates an after-tax return of at least 2% of the amount of its financing activity. The Circular does not define the term "pure intermediary activities." Intragroup financing companies may deviate from the foregoing standard based on a reasoned transfer pricing report that economically justifies the deviation.

Finally, the Circular states that all rulings and other individual administrative decisions in relation to the arm's length principle will no longer be binding on the L.T.A. as of January 1, 2017, for tax years beginning after 2016. Whereas the Circular addresses intragroup financing companies, the above statement is worded without restriction in scope. It is therefore unclear whether it targets more than just transfer pricing rulings obtained by intragroup financing companies.

Taxpayers wishing to have certainty on transfer pricing continue to have the option to file an A.P.A. with the Luxembourg direct tax authorities, as discussed in Section 5.L.vi.

iii. General Anti-Abuse Rule ("G.A.A.R.")

The wording of the existing domestic G.A.A.R. provision is in line with the A.T.A.D.'s wording, introducing the concept of a nongenuine arrangement. G.A.A.R. can apply if obtaining a tax advantage is the main purpose or one of the main purposes of the arrangement.

iv. I.P. Regime

On March 22, 2018, Luxembourg adopted an I.P. regime set out in article 50ter I.T.A. (the "I.P. Regime") effective January 1, 2018. The I.P. Regime applies to any Luxembourg tax resident carrying out a business activity in Luxembourg and owning qualifying I.P.

Eligible net income from qualifying I.P. assets may benefit from an exemption of up to 80% for income taxes and 100% for net wealth tax. The eligible assets must have been developed or improved after December 31, 2007, and are limited to patents, utility models, supplementary protection certificates granted for a patent on medicine and plant protection, plant variety certificates, extensions of a complementary protection certificate for pediatric use, orphan drug designations, and software protected by copyrights.

The portion of the I.P. income benefiting from the advantageous tax treatment is calculated based on a ratio that takes into account the R&D costs. The ratio corresponds to the eligible R&D costs divided by the overall R&D expenses. Luxembourg allows the eligible R&D costs to be uplifted by 30% insofar as the resulting ratio does not exceed the total amount of expenditure. Expenses must be incurred within the framework of an R&D activity, but need not be undertaken by the taxpayer. Outsourced activity is eligible for favorable treatment.

The I.P. Regime is in line with the recommendations made by the O.E.C.D., and adopts a nexus approach to ensure that only the R&D activities having nexus with the Luxembourg taxpayer itself may benefit from the I.P. Regime. I.P. assets of a marketing nature (*e.g.*, trademarks) are excluded from the scope of the proposed regime.

v. <u>Real Estate Tax for Investment Vehicles</u>

Certain investment vehicles are subject to a real estate tax on income derived from real estate assets situated in Luxembourg. The tax is imposed at a flat rate of 20%.

The investment vehicles that are within the scope of this new tax are (i) specialized investment funds ("S.I.F."), (ii) so-called "Part II" undertakings for collective investment ("U.C.I."), and (iii) reserved alternative investment funds ("R.A.I.F"), provided the vehicle in issue is neither a tax transparent partnership nor a common placement fund ("F.C.P."). The tax applies to income and gains derived from Luxembourg real estate assets held directly and indirectly via a partnership or an F.C.P.

Income derived from real estate assets includes (i) gross rental income and capital gains upon the disposal of a Luxembourg real estate asset, such as a sale, contribution, or merger, and (ii) income from the disposal of an interest in certain tax transparent entities, such as a partnership or an F.C.P., to the extent the value of the interest reflects the value of real estate located in Luxembourg. The tax is due in full even when the transaction is not accompanied by a cash payment as is the case in an intragroup restructuring.

The L.T.A. released an administrative circular which clarified the filing obligations required by the Real Estate Levy for Investment Fund Vehicles. As of May 31, 2022, all investment vehicles under the scope of the Real Estate Levy (*i.e.,* S.I.F.'s, U.C.I.'s and R.A.I.F.'s) need to respond to certain inquiries regarding real estate situated in Luxembourg.

Investment vehicles inside the scope of the Real Estate Levy which hold Luxembourg real estate must file an annual return declaring the qualifying real estate income with a detailed breakdown of each property by May 31 of the following year.

vi. Advance Tax Agreements and Advance Pricing Agreements

The procedure to obtain an A.T.A. is codified into Luxembourg law. In an A.T.A., the L.T.A. confirm the interpretation of the tax law as applied to the specific facts of the case presented by the taxpayer. Following submission, an A.T.A. request will be reviewed by a committee that will advise the relevant tax inspector. Submission of a request is subject to a fee of up to €10,000 payable to the L.T.A.

A.T.A.'s obtained by a taxpayer are binding on the tax authorities unless one of the requirements set out in the law is no longer met. A.T.A.'s obtained prior to the introduction of the legal framework for obtaining advance confirmation in 2015 are in most cases valid indefinitely, unless (i) the circumstances or transactions were described incompletely or inaccurately, (ii) the circumstances or transactions that took place at a later stage differ from those underlying the A.T.A., or (iii) the A.T.A. is no longer compliant with national, E.U., or international law.

Subject to the foregoing requirements, case law[10] provides that an A.T.A. continues to bind the L.T.A. notwithstanding a change of policy under the following conditions:

- The question and fact pattern submitted to the tax authorities are clear and included all elements necessary to allow the tax authorities to make an informed decision.

- The decision was issued by a competent civil servant, or by a civil servant of which the taxpayer could legitimately believe that he was competent.

- The administration intended to bind itself, *i.e.,* the answer was given without restrictions or reservations.

- The answer provided by the administration must have had a decisive influence on the taxpayer.

---

[10] Administrative Court, July 12, 2016, no. 37448C.

However, a law adopted on December 20, 2019, provides for the automatic expiration of A.T.A granted prior to 2015 expired upon completion of the 2019 tax year. Should taxpayers want similar comfort for subsequent tax years, a new request may be filed under the new procedure. The explicit language of the law to that effect seems to imply that the fact that a new ruling request would be filed only after the transaction had occurred should not be an obstacle to obtaining such a ruling.

As for intragroup transactions, the arm's length character of the remuneration to be earned by a Luxembourg company may be confirmed by the tax authorities in an advance pricing agreement ("A.P.A"). However, the issuance of an A.P.A. is subject to certain conditions, set out in an administrative circular issued by the L.T.A. on December 27, 2016 (the "Circular"). Such conditions include, *inter alia*, the following:

- The relevant employees or board members of the Luxembourg entity are qualified to carry out the functions and tasks assigned to the Luxembourg entity.

- The countries affected by the financing transactions have been listed.

- Full information has been provided regarding the parties involved in the controlled transaction.

- A detailed transfer pricing analysis has been submitted. See in this respect Section 5.L.ii.

vii. State Aid Investigations by the European Commission

Over the last few years, the Commission has continued its examination of the A.T.A. and A.P.A. practices of various E.U. Member States, including Luxembourg, in light of the existence of unlawful State Aid by way of an A.T.A. or A.P.A. The Commission has repeatedly stated that an A.T.A. or A.P.A. that merely confirms in advance the application of tax law in a particular case is legitimate. On the other hand, an A.T.A. or A.P.A. that grants State

Aid is not allowed under the E.U. treaties. In that regard, it is generally unlawful for E.U. Member States to grant aid in the form of a tax advantage on a selective basis to undertakings. If it is determined that unlawful aid was granted, the Commission can order the Member State to recover that aid from the beneficiary undertaking, with interest due on the collected amount, as if it were a loan.

Regarding Luxembourg, the Commission has investigated A.T.A.'s issued to GDF Suez, Amazon, McDonald's, Fiat Finance and Trade ("F.F.T."), and Huhtamaki to determine whether A.T.A.'s amounted to unlawful State Aid.

On October 21, 2015, the Commission's adverse decision with regard to F.F.T. was published (Decision C (2015) 7152 final), stating that Luxembourg granted selective tax advantages to F.F.T. The Commission ordered Luxembourg to recover the unpaid tax from F.F.T. in order to remove the unfair competitive advantage that was granted and to restore equal treatment with other companies in similar situations. In addition, F.F.T. can no longer continue to benefit from the tax treatment granted by the tax rulings. The E.U. General Court also upheld the Commission's decision in the Fiat case, maintaining that Luxembourg granted unlawful State Aid to a Luxembourg treasury company of the Fiat group. The General Court criticized specific aspects of the transfer pricing position. In particular, it questioned the amount of equity deemed at risk, which was seemingly much lower than the equity in reality at risk, and the application of the equity at risk remuneration only to that small portion of equity deemed at risk.

On November 8, 2022, the Court of Justice of the E.U. delivered its judgment in the Luxembourg State Aid case concerning F.F.T. The Court of Justice annulled both the judgment of the General Court of the European Union and the Commission's decision. The C.J.E.U. concluded that the Commission did not establish that Luxembourg granted a selective tax advantage to the financing company by agreeing in the A.T.A. concluded on June 9, 2016, to transfer prices that, according to the Commission, deviated from market practices. This case is the first to reach a final decision from the C.J.E.U. regarding the Commission's investigations into alleged State Aid granted by E.U. Member States regarding direct tax.

On October 4, 2017, the Commission reached an adverse decision in the Amazon case (Decision (E.U.) 2018/859). The case concerns the arm's length nature of royalty paid by a Luxembourg company to a Luxembourg partnership. The decision ordered Luxembourg to recover the State Aid from Amazon. Luxembourg challenged the decision to the European Union General Court (case T-816/17). On May 12, 2021, the General Court of the E.U. annulled the Commission's decision. The Commission filed an appeal with the Court of Justice of the E.U. which was decided on December 14, 2023, in favor of the taxpayer. The Commission's decision breached E.U. law and was annulled.

On June 20, 2018, the Commission reached an adverse decision in the Engie case (Decision (E.U.) 2019/421). The case concerns the tax position of three companies involved in a domestic "hybrid" instrument structure and whether Luxembourg should have applied its domestic anti-abuse rule. The Commission found that Luxembourg granted unlawful State Aid to Engie. Luxembourg appealed this decision to the European Union General Court (cases T-525/18 and T-516/18, respectively). On May 12, 2021, the General Court of Justice of the E.U. upheld the Commission decision of June 2018, finding that Luxembourg granted unlawful State Aid to Engie. Engie and Luxembourg filed an appeal with the Court of Justice of the E.U. On December 5, 2023, the Court annulled both the judgment of the General Court and the Commission's decision. It concluded the Commission did not establish that Luxembourg granted a selective tax advantage and was in breach of E.U. law.

On September 19, 2018, the Commission took a positive decision in the McDonald's case, stating that Luxembourg did not grant McDonald's a selective advantage (Decision C (2018) 6076 final). The case concerned a mismatch in the context of U.S. branch.

On May 3, 2019, the Commission published its opening decision (Decision C (2019) 1615 final dated March 7, 2019) in the Huhtamaki case. The case concerns A.T.A.'s issued by the L.T.A. to the Finnish packaging group in 2009, 2012, and 2013. These rulings concern a Luxembourg intragroup financing company funded with interest-free loans ("I.F.L.") granted by an Irish sister company. The A.T.A.'s allowed the Luxembourg company to impute a deduction for deemed interest expenses on the I.F.L. for M.B.T. and C.I.T. purposes. In the Commission's view, the allowance of a notional deduction constituted a selective advantage which deviated from Luxembourg's reference system (*i.e.*, its corporate income tax).

viii. Claim and Tax Objections

The deadline for filing a claim (*réclamation*) against a decision of the L.T.A. is three months from the notification of the assessment. For now, the regular objection deadline still applies.

After the decision of the L.T.A., a taxpayer can object to the decision in front of an administrative court. The deadline for filing an objection against a decision is three months. The deadline for filing an appeal of a judgment of the administrative tribunal is 40 days.

ix. Exchange of Information

Luxembourg and the United States concluded a Model 1 Intergovernmental Agreement ("I.G.A.") regarding the application of F.A.T.C.A. in Luxembourg on March 28, 2014. The I.G.A. was implemented in Luxembourg domestic law by a law dated July 24, 2015. Reporting Luxembourg financial institutions must give specified information on their U.S. account holders to the L.T.A., which in turn pass that information to the U.S. I.R.S.

Luxembourg has also implemented the O.E.C.D.'s common reporting standard ("C.R.S.") and the revised E.U. directive on administrative cooperation (2014/107/E.C.), which effectively implements the C.R.S. into E.U. law. Luxembourg financial institutions therefore must comply with additional due diligence rules for their account holders and the shareholders of investment entities. Further, additional reporting rules apply for Luxembourg financial institutions with financial accounts held by persons who are tax resident in an E.U. Member State or a country participating in the C.R.S.

On December 8, 2015, the E.U. Council adopted Directive 2015/2376/E.U. (the "E.O.I. Directive") amending Directive 2011/16/E.U. regarding the mandatory automatic exchange of information in the field of taxation. The E.O.I. Directive was implemented in Luxembourg by law on July 23, 2016, and was introduced as of January 1, 2017. It covers the mandatory automatic exchange of information on advance cross-border rulings and advance pricing arrangements and is aimed at enhancing fiscal transparency between E.U. Member States and deterring aggressive tax planning and abusive tax practices.

The automatic exchange should include a defined set of basic information that will be sent to all Member States and the E.U. Commission (though the latter's access is limited). After the exchange of information takes place, an E.U. Member State may request additional information if it believes the information is relevant to the application of its own tax rules. The information is covered by Form 777E, which serves to summarize the content, scope, and application of the A.T.A./A.P.A.

The automatic exchange covers A.T.A.'s/A.P.A.'s (i) issued, amended, or renewed after December 31, 2016 and (ii) issued less than five years prior to January 1, 2017. Only rulings involving cross-border transactions are covered by the E.O.I. Directive, and rulings concerning only natural persons are excluded.

Rulings and pricing arrangements issued after December 31, 2016, must be communicated within three months following the end of the calendar-year semester in which issued. Rulings and advance pricing arrangements issued between January 1, 2012, and December 31, 2013, which are still valid on January 1, 2014, and rulings and advance pricing arrangements issued between January 1, 2014, and December 31, 2016, (whether still valid or not) were reported before January 1, 2018. Rulings and advance pricing arrangements issued before April 1, 2016, concerning persons with a group-wide annual net turnover exceeding €40 million are not reported.

As a result of the implementation into the laws of the Member States of the E.U. Directive (E.U./2018/822) introducing mandatory disclosure rules (the "Mandatory Disclosure Directive"), advisers, other intermediaries, and taxpayers may be legally required to disclose information to E.U. Member States' tax authorities on certain advice given and services rendered regarding cross-border tax planning arrangements that qualify as reportable cross-border arrangements. The domestic law relating to the Mandatory Disclosure Directive entered into force on January 1, 2021. In addition, each relevant taxpayer must annually disclose in a tax return how the arrangement was used.

On May 16, 2023, Luxembourg implemented the E.U directive 2021/514 amending Directive 2011/16/E.U. on administrative cooperation in the field of taxation, which introduces new rules for the automatic exchange of information for digital platform operators and creates a legal framework for joint audit with other Member States.

x. Country-by-Country Reporting

On December 13, 2016, the Luxembourg Parliament adopted a law on Country-by-Country Reporting ("C-b-C Reporting"), in accordance with E.U. Directive 2016/881 of May 25, 2016, requiring the implementation of a C-b-C Reporting obligation in Member States' national legislation. The obligation to prepare a C-b-C Report applies to large multinational enterprise groups with total consolidated group revenue that exceeds €750 million during the previous fiscal year. Each Luxembourg tax resident entity that is the parent entity of a multinational group, or any other reporting entity defined in the draft law, must file a C-b-C Report with the L.T.A. In addition, the law introduced a secondary reporting mechanism whereby the reporting obligations are, under certain conditions, shifted from the parent company to a Luxembourg subsidiary or a permanent establishment. The deadline for the submission of C-b-C Reports is 12 months after the last day of the relevant fiscal year. In addition, each Luxembourg entity that is part of a multinational enterprise group must notify the L.T.A. on an annual basis of the identity of the entity that will be filing the C-b-C Report for the year concerned. The deadline for this notification is the last day of the fiscal year of the multinational enterprise group.

On July 21, 2023, a bill (Bill no. 8158) was adopted by the Luxembourg parliament. It took effect in Luxembourg for accounting periods beginning on or after June 22, 2024.

M. <u>S.I.C.A.R.</u>

The S.I.C.A.R. law provides a flexible and tax-favorable regime for any investments in risk-bearing capital. The purpose of this law is to facilitate private equity and venture capital investments within the E.U.

A S.I.C.A.R. can be incorporated in the form of a capital company, such as an S.à.r.l. or an S.A., or a transparent entity, such as a *société en commandite simple* ("S.C.S.") or *société en commandite spéciale* ("S.C.S.P."). A S.I.C.A.R. is a regulated entity, though in a relatively light manner compared to certain other Luxembourg investment funds such as Undertakings for Collective Investments in Transferable Securities ("U.C.I.T.S."). The S.I.C.A.R. is subject to prior approval and supervision by the *Commission de Surveillance de Secteur Financier* ("C.S.S.F."). It benefits from flexible legal rules regarding investment in private equity and venture capital.

In principle, a S.I.C.A.R. organized as a capital company is fully taxable for C.I.T. purposes. However, income realized in connection with its investments in risk-bearing securities is fully exempt from C.I.T. Other income, such as interest accrued on bank deposits, management fees, and the like, is normally taxed. In a cross-border situation, the L.T.A. take the position that a S.I.C.A.R. is entitled to the benefits of the Luxembourg tax treaties and the P.S.D. In addition, a S.I.C.A.R. is exempt from net worth tax (except for minimum net worth tax of €4,815) and from withholding tax on dividend distributions. Nonresident investors in a S.I.C.A.R. are not subject to Luxembourg taxes on dividends distributed or capital gains realized on the disposal of the shares in the S.I.C.A.R. A S.I.C.A.R. is subject to the minimum tax rules, as described above in Section 5.A.ii.

A S.I.C.A.R. organized as a limited partnership is not subject to C.I.T. due to its tax transparency. As a result, its profits will not be liable to Luxembourg income taxes at fund and the investor level, nor will its distributions give rise to withholding tax.

N. <u>S.I.F.</u>

The S.I.F., introduced by the S.I.F law in 2007, is a lightly regulated fund reserved for well-informed investors which is subject to risk diversification. The S.I.F. is an income tax exempt entity. If structured as an F.C.P. or a partnership, it is fully tax transparent.

The S.I.F. is subject to a subscription tax of 0.01% of its net assets, with an exemption possible for certain money market and pension funds, or S.I.F.'s investing in other funds already subject to subscription tax.

O. <u>R.A.I.F.</u>

The R.A.I.F. is an attractive regime created in July 2016. It allows for flexible establishment and operating rules: its setup does not require approval by the C.S.S.F., and it is also allowed certain structuring features which at present are available only to regulated A.I.F.'s (*e.g.,* umbrella structure, variable capital, specific tax regime). In addition, access to the marketing passport as per Directive 2011/61/E.U. on A.I.F. managers (the "A.I.F.M.D.") is available, and investors' protection is ensured by the full application of the A.I.F.M.D. regime at the manager's level.

R.A.I.F.'s are by default only subject at the fund entity level to an annual subscription tax levied at a rate of 0.01% of its net assets. Irrespective of the legal form chosen for an R.A.I.F., it will not be subject to C.I.T., municipal business tax, or net wealth tax, and distributions of profits by an R.A.I.F. will not give rise to a withholding tax.

As an alternative to the default tax regime, a R.A.I.F. may choose to be taxed according to the same tax rules as those applicable to S.I.C.A.R.'s, as described above in Section 5.M.

P. <u>Securitization Vehicles</u>

Luxembourg has also adopted an attractive legal, regulatory, and tax framework for securitization vehicles (the "S.V. Law").

The S.V. Law defines "securitization" very broadly:

> The transaction by which a securitization vehicle acquires or assumes, directly or through another vehicle, the risks relating to claims, obligations, and other assets or to the activity of a third party by issuing securities the value or the yield of which depends on such risks.[11]

A securitization vehicle can either be set up in the form of a capital company, such as an S.à.r.l., S.A., S.C.A., or *société commerciale*, or in the form of a fund managed by a management company. Securitizations with Luxembourg special purpose vehicles outside the scope of the S.V. Law are also possible.

Securitization vehicles that issue securities to the public on a regular basis are subject to prior approval and supervision by the C.S.S.F. Issuances of securities to the public or continuous private placements do not require prior approval. Securitization vehicles that set up as funds are, as a general rule, subject to prior approval and supervision by the C.S.S.F.

The S.V. Law offers flexibility and protection of investors' and creditors' rights, and ensures bankruptcy remoteness of the securitization vehicle, by expressly confirming the effectiveness of "non-petition" and "non-attachment" clauses. In addition, the S.V. Law expressly allows for subordination provisions and validates the "true sales" character of the transfer of the securitized assets to the securitization vehicle.

It also recognizes that investors' and creditors' rights and claims are limited in recourse to the securitized assets and enables the creation of separate compartments within a single securitization vehicle, each comprising a distinct pool of assets and liabilities.

Securitization vehicles are, in principle, fully subject to Luxembourg C.I.T. at the standard combined rate of 24.94%. However, the securitization vehicle is able to deduct from its taxable base all "commitments" owed to investors and creditors. A commitment should be interpreted as including all payments

---

[11] Article 1(1) of the law of March 22, 2004, on securitization.

declarations, or properly accrued amounts, either in the form of interest or dividends, made by the securitization vehicle to its investors and creditors. The taxable result of a securitization vehicle therefore is generally nil or close to nil albeit that the interest deduction limitation rules referred to above in Section 5.I.ii apply to interest payments made by a securitization vehicle and a securitization vehicle is subject to the minimum net worth tax described above in Section 5.A.[12] Securitization vehicles set up in the form of a partnership are generally considered transparent for C.I.T. and M.B.T. purposes.

Dividend distributions from a securitization vehicle are not subject to withholding tax as such distributions are treated as business expenses of the securitization vehicle. A S.O.P.A.R.F.I. receiving dividends from, or realizing gain on the sale of shares in, a securitization vehicle is not entitled to the participation exemption.

In a cross-border situation, the L.T.A. take the position that the securitization vehicle should be entitled to the benefit of withholding tax relief with respect to dividends sourced in a treaty country or in an E.U. Member State under the P.S.D. Cross-border tax relief with respect to dividends received or distributed by a securitization vehicle depends on the analysis made by the other E.U. Member States and treaty countries.

Securitization vehicles are exempt from net worth tax other than minimum net worth tax.

---

12 Luxembourg securitization vehicles structured as entities that are not standalone but are not subject to consolidation requirements may be exempt from the interest deduction limitation rule under certain conditions, as further explained in the Section 5.Q.v.

Q. Recent and Current Developments

i. Codification of the Practice of Redemption of Classes of Shares

On December 11, 2024, bill number 8388 ("Bill 8388") was approved by the Luxembourg parliament introducing, among other things, provisions concerning the tax treatment of the repurchase and cancelation of a class of shares, codifying a well-established practice in Luxembourg.

The provisions in Bill 8388 stipulate that the repurchase and cancellation of an entire class of shares is to be treated as a partial liquidation and therefore exempt from withholding tax. For the treatment to apply, the following conditions must be met:

- The redemption and cancelation should concern the entire class of shares.

- The cancelation should take place within six months from the repurchase.

- The share classes should be created at incorporation of the entity or on the occasion of a capital increase.

- Each class of shares should have different economic rights, such as preferred return, exclusive rights to profits for a certain period, or profits entitlement linked to the performance of the underlying asset (*i.e.,* tracking features).

- The criteria for determination of the repurchase price are determined or determinable on the basis of the articles of association (or another document referred to within the articles of association) and reflect the fair market value of the class of shares at the time of the repurchase.

In cases where a shareholder whose shares are being repurchased and cancelled is an individual who owns a substantial shareholding (10% or more) in the Luxembourg company, the company must disclose information identifying the individual shareholder in its tax return.

ii. Amendments to the Minimum Net Worth Tax Rules

Bill 8388 further introduced amendments to the existing minimum net worth tax rules as explained in Section 5.A.iii above. The amendments follow from the decision of the Luxembourg Constitutional Court that the previous provisions were unconstitutional.[13]

Based on the new rules, the minimum net worth tax is determined on the basis of a company's total balance sheet without any additional criteria. A company with a balance sheet total of up to €350,000 will be subject to a minimum net worth tax of €535, a company with a balance sheet total of more than €350,000 but less than €2 million will be subject to minimum net worth tax of €1,605, and a company with a balance sheet total of more than €2 million will be subject to minimum net worth tax of €4,815.

The provisions of Bill 8388 in respect to the minimum net worth tax apply for the 2025 fiscal year and following years.

iii. Possibility to Opt Out of the Participation Exemption

Bill 8388 introduced amendments to Article 166 (1) of the I.T.A. and Article 115 (15) of the I.T.A. which provide for the possibility to opt out of the application of the participation exemption (described in Section 5.B above) and the partial participation exemption (described in the Section 5.G above).

The possibility to opt out of the exemption is possible for Luxembourg companies entitled to the (partial) participation exemption solely by application of the acquisition price criterion (€1.2 million for dividends and liquidation proceeds and €6 million for capital gains) and is not available for participations of 10% that do not meet the acquisition price criterion.

---

[13] *Supra* note 2, above.

The option is to be exercised explicitly in a tax return for each fiscal year.

iv. Pillar Two – Implementation in Luxembourg

On December 14, 2022, E.U. Member States adopted E.U. Council Directive 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the E.U., known as the Pillar Two Directive.

On December 20, 2023, Luxembourg parliament adopted the law transposing the text of the E.U. Pillar Two Directive into domestic law. The law entered into force for fiscal years starting on or after December 31, 2023. The Income Inclusion Rule ("I.I.R.") and the Qualified Domestic Minimum Top-up Tax ("Q.D.M.T.T.") are effective for fiscal years starting on or after December 31, 2023. The Undertaxed Profits Rule ("U.T.P.R.") becomes effective for fiscal years starting on or after December 31, 2024. The I.I.R., Q.D.M.T.T., and U.T.P.R. are explained in more detail in Chapter 3 of this article, regarding B.E.P.S.

A bill presented to the Luxembourg Parliament on December 22, 2024, was approved in June 2024, incorporating clarifications to the law on Pillar Two. The legislation was derived from the O.E.C.D. guidance on the application of Pillar Two published in February, July, and December of 2023.

v. Amendments to the Interest Deduction Limitation Rule

On December 11, 2024, the Luxembourg Parliament adopted bill number 8414 ("Bill 8414") which, among other measures, introduces clarifications to Article 168*bis* I.T.A. on Luxembourg interest deduction limitation rules (explained in Section 5.I.ii).

Bill 8414 introduces the concept of a "single company worldwide group" or "S.C.W.G.," which are entities that (i) are not part of a consolidated group for financial purposes and (ii) are not considered autonomous, standalone entities. For an entity to avoid being considered autonomous, it should have one or more associated entities and/or at least one permanent establishment outside of

Luxembourg, within the meaning of article 164*ter*, paragraph 2 of I.T.A.

S.C.W.G. entities will be able to deduct all borrowing costs if they can prove that the equity-to-asset ratio of the entity is at least equal to the ratio of the group. The equity-to-asset ratio will be presumed equal to that of the group if it is lower than 2%. This exemption is applicable upon request of the taxpayer and is subject to specific anti-abuse rules.

For the purposes of calculating the equity-to-asset ratio of the group, the equity of the group is to be increased by the amounts that could give rise to borrowing costs and are owed by the entity to associated enterprises within the meaning of Article 168*ter*, paragraph 1, point 18 I.T.A. For the purposes of this determination, the 50% threshold for "associated enterprise" referred to in Article 168*ter*, paragraph 1, point 18 of I.T.A. is reduced to 25%.

The application of the exemption from the deduction limitation is applicable upon request, as of fiscal year 2024. It is subject to specific anti-abuse rules.

6. BELGIUM[1]

Over the last decades, Belgium has become a competitive player in the international tax arena. Despite a relatively high corporate income tax ("C.I.T.") rate of 25% in comparison with some other E.U. jurisdictions, Belgium offers a wide-range of tax-planning opportunities for Belgian holding and operating companies and Belgian branches of foreign companies.[2]

These opportunities include, but are not limited to, the following:

- The participation exemption, also referred to as the dividend received deduction ("D.R.D."),[3] which fully exempts from C.I.T. dividends received from qualifying subsidiaries and

1 This chapter of the article was written by Werner Heyvaert. The author acknowledges the contribution of his colleague, Yannick Vandenplas of AKD in Brussels.

2 The Belgian branch of a foreign company can be a valuable alternative to a Belgian company because, *inter alia*, there is no dividend withholding tax ("W.H.T.") or branch profits tax due on the repatriation of branch income to the head office. In most instances, however, foreign investors operate in Belgium through a subsidiary that adopts a corporate form rather than a branch. Although several corporate forms exist under Belgian corporate law, the most commonly used are the Public Limited Liability Company (S.A./N.V.) and the Limited Liability Company (S.R.L./B.V.). From a Belgian tax perspective, both the S.A./N.V. and the S.R.L./B.V. are subject to identical C.I.T. rules. The use of non-corporate entities, such as partnerships, is relatively limited.

3 D.R.D. translates to *revenus définitivement taxés* or R.D.T. in French and *definitief belaste inkomsten* or D.B.I. in Dutch.

capital gains realized on the shares of qualifying subsidiaries

- The innovation income deduction, which allows a deduction of 85% of qualifying innovation income determined in accordance with the O.E.C.D.'s nexus rules[4]

- The increased investment deduction, which allows the deduction of a percentage of the acquisition or investment value of qualifying assets that have been acquired or developed during the taxable period and are related to R&D. This deduction comes in addition to the annual depreciation of qualifying assets.

- Tax losses may be carried forward indefinitely

- The ruling practice, which allows taxpayers to obtain a binding opinion from the Belgian Tax Ruling Committee on tax issues and the Belgian Accounting Standards Committee on accounting issues

- The absence of capital tax and of a net wealth tax

- The deductibility of finance costs

- The extensive Belgian tax treaty network

- The application of the E.U. Parent-Subsidiary Directive ("P.S.D.") to all tax treaty countries

This chapter examines the relevant tax aspects for multinationals doing business or planning to do business with or through Belgian holding companies.[5] Where relevant, recent amendments to Belgian

---

4 The I.I.D. can be combined with another Belgian tax incentive that is the 80% wage W.H.T. exemption for qualifying scientific workers.

5 For the economic substance requirements in Belgium and the E.U., see W. Heyvaert et *al.*, "Economic Substance: Views From the U.S., Europe, and the B.V.I., Cayman and

tax law are also discussed. With a statute of limitation of at least three years, historic rules remain relevant in case of a tax audit covering previous years.[6]

Following the Belgian general elections on June 9, 2024, five political parties negotiated a new Federal government agreement (the "Belgian Government Agreement"). The Belgian Government Agreement consists of more than 200 pages and contains many significant tax measures, including the following provisions:

- The replacement of the D.R.D. by an exemption
- The modernization of the group contribution regime, the Belgian equivalent of group relief
- The simplification of the investment deduction rules, the Belgian equivalent of investment credits in the U.S.
- The adoption of accelerated depreciation rules for CAPEX investments

---

Nevis," *Insights*, Vol. 10, No. 3 (2023), pp. 5-27, spec. pp. 15-23 (available at https://publications.ruchelaw.com/news/2023-05/EconomicSubstance.pdf).

6 When a taxpayer fails to submit a tax return or does not do so within the designated timeframe, the statute of limitation is extended to four years. In an international context, such as when a taxpayer claims a foreign tax credit or seeks an exemption, waiver, or reduction of W.H.T. through a tax treaty or an E.U. Directive, the statute of limitation is extended to six years. For cases involving alleged fraud or "complex" tax returns, such as those involving Belgian controlled foreign companies or hybrid mismatch rules, the statute of limitations is further extended to ten years. In some circumstances, the statute of limitations is even longer; this is the case, for example, when the Belgian Revenue Service receives information from foreign revenue services.

- The adoption of a "solidarity contribution," a 10% capital gains tax on financial assets held by individuals (the "Solidarity Contribution")

- Simplification of disallowed expense rules

- The adoption of carried-interest rules for managers of investment funds

The Belgian Government Agreement presents many tax measures only in brief and general terms. At the time of writing, two draft bills (the "Bills") are circulating, one of which was submitted to the House on May 27, 2025. The draft bill submitted to the House contains various measures, while the other bill focuses specifically on the Solidarity Contribution. Both of the Bills remain subject to political debate and potential amendments. Where the announced new rules impact the tax regimes discussed below, we will indicate this in the main text or in the footnotes, referencing "Announced New Rules."

A. Corporate Income Tax

i. General Regime

Companies are subject to Belgian C.I.T. if all of the following three conditions are met:[7]

- They have a separate legal personality under Belgian or foreign corporate law or, if the governing foreign corporate law does not confer legal personality, they have a legal form that is comparable to a legal form that has legal personality under Belgian corporate law.

- They carry on a business or are engaged in profit-making activities.

---

7 Article 179 of the Belgian Income Tax Code ("I.T.C."), read in parallel with Article 2, ¶1, 5°, a) and b) I.T.C.

- They have their effective place of management or control in Belgium.[8]

Companies are subject to Belgian C.I.T. on their worldwide profit, including distributed dividends. The taxable income is determined on the basis of the commercial accounts and the accounting rules, unless the tax laws provide otherwise.[9]

Companies must use their standalone Belgian G.A.A.P. accounts to prepare their C.I.T. return; accounts prepared using I.A.S. or I.F.R.S. cannot be utilized for Belgian C.I.T. purposes.

ii. Corporate Income Tax Rate

Following a major overhaul of Belgium's C.I.T. in 2017, the standard C.I.T. rate is 25%.[10]

Companies may benefit from a reduced rate of 20% for the first €100,000 of taxable income if all of the following conditions are met:[11]

---

8 Although Belgian corporate law recently switched to the "statutory seat" doctrine, Belgian tax law still applies the "real seat" doctrine. When a company has its statutory seat in Belgium, it is presumed to have its real seat in Belgium, too. The company may rebut this presumption if it can establish that its tax residency is in another country in accordance with the tax legislation of that country. The concept of "effective place of management of control" or "real seat" refers to a factual situation. In practice, the real seat will be the place where the principal directors meet, where the shareholders' meetings are held, where the ultimate management of the company takes place and where the impulse in the company is given.

9 Article 24, third limb I.T.C.

10 Article 215 I.T.C.

11 Article 215, second limb I.T.C.

- It qualifies as a small or medium-sized enterprise ("S.M.E.") within the meaning of the Belgian Code on Companies and Associations ("B.C.C.A."). The B.C.C.A. defines an S.M.E. as a company which, on the balance sheet of the last two financial years, does not exceed more than one of the following criteria:[12]

  (i) An annual average of 50 employees

  (ii) Annual net sales of €11.25 million, excluding V.A.T.

  (iii) A balance sheet total of €6 million

- At least 50% of the company's shares are held by individuals.[13]

- It pays, from the fifth taxable period following its incorporation, annual compensation of €45,000[14] or more to at least one manager of the company that is a natural person. The annual compensation can be lower if it is at least equal to the company's taxable income.[15]

- It is not an investment company.[16]

- It does not hold participations in one or more other companies that have a combined acquisition value that exceeds 50% of either the revalued paid-up capital of the company or the paid-up capital, taxed reserves, and

---

12 Article 1:24 B.C.C.A.

13 Article 215, third limb, 2° I.T.C.

14 **Announced New Rule**: The Belgian Government Agreement provides that the minimum annual compensation will be raised to €50,000, which will be indexed annually for inflation.

15 Article 215, third limb, 4° I.T.C.

16 Article 215, third limb, 6° I.T.C.

recorded capital gains of the company. Participations of at least 75% are excluded from this calculation.[17]

Most Belgian holding companies will not be eligible for the reduced rate because, *inter alia,* less than 50% of their shares will be held by individuals.

iii. Minimum Taxable Base

Companies with a taxable profit that exceeds €1 million cannot fully benefit from certain tax attributes such as a tax loss carryforward or a D.R.D. carryforward. In the profitable year, the benefit is capped at 70% of the taxable profits in excess of €1 million.[18] As a result, 30% of the taxable profits that exceed €1 million in the carryforward year will be subject to the standard Belgian C.I.T. rate of 25%. The unused tax attributes can be carried forward to following taxable years until finally used. Belgian holding companies, therefore, need to re-assess their use of tax attributes and their recognition of related deferred tax assets.

iv. Taxation of Dividends Received

a. In General

Dividends received by a Belgian company are in principle subject to the standard 25% C.I.T. rate or the reduced rate of 20% for the first €100,000 of taxable income, if applicable.

The D.R.D. regime is the Belgian implementation of the E.U. Parent-Subsidiary Directive ("P.S.D."). Under the P.S.D., profit distributions from subsidiaries to parents established in the E.U. are, in principle, tax exempt. Member States have two options to achieve this: they can either refrain from taxing dividends received by the parent or its P.E. under the exemption method, or they can tax the dividends and allow the parent or its P.E. to deduct the tax paid by the subsidiary and any sub-subsidiaries through the credit method.

---

17 Article 215, third limb, 1° I.T.C.

18 See Article 207, fifth limb I.T.C.

When implementing the P.S.D., Belgium chose the exemption method, but with a unique two-step system. First, the dividend received is added to the tax base of the parent. Then, after dividing the aggregate profit into three baskets – Belgian-source profit, profit exempt by virtue of a tax treaty, and profit not exempt by virtue of any tax treaty – the dividend is deducted from the Belgian tax base. However, this two-step approach can result in less favorable tax treatment than a pure and simple exemption of the dividend in certain circumstances, which is incompatible with E.U. law. Notable cases highlighting this incompatibility include E.C.J. rulings such as *Cobelfret* (February 12, 2009, C-138/07), *KBC Bank* (June 4, 2009, C-439/07)*, Brussels Securities* (December 19, 2019, C-389/18), and most recently, the notorious *John Cockerill* case, which was ruled on by the E.C.J. on March 13, 2025.[19] In the *John Cockerill* case, the issue was that the recipient company of an intragroup profit transfer (the Belgian equivalent of a partial tax consolidation) was not allowed to apply the D.R.D. on such transferred profit. As a result, the transferred profit became effectively subject to taxation, while the excess D.R.D. that could

---

19 **<u>Announced New Rule</u>**: It is proposed that the two-step process of inclusion of all dividend income into taxable income followed by a conditional deduction of qualifying dividends (D.R.D.) will be replaced by a simple exemption for qualifying dividend income, akin to the system that is currently in place for the exemption of capital gains on qualifying shares. This should lead to a substantial simplification and is also in line with the P.S.D. This measure will address the existing incompatibilities of the D.R.D. regime with the P.S.D. However, the Bills indicate that, as an initial step, the statutory provision prohibiting the D.R.D. from being credited against an intragroup profit transfer – which the E.C.J. found incompatible with the P.S.D. – will be abolished immediately in 2025. The broader reform of the D.R.D. regime is expected to be implemented at a later time. It is interesting to note that the anticipated reform of the D.R.D. with the adoption of a full exemption system will apply across the board – regardless of where the dividends come from, whether from another E.U. Member State, Belgium, or a "third country."

not be utilized in the current year was carried forward to the following tax year.

b. <u>Participation Exemption</u>

Dividends received by a Belgian company may be fully exempt under the D.R.D. regime if all of the following conditions are met:

- **Minimum Participation Value**: The recipient company owns at least 10% of the nominal share capital[20] of the subsidiary making the payment *or* the acquisition value of its holdings in the subsidiary is at least €2.5 million.[21]

---

20 Under the B.C.C.A., the concept of "capital" has ceased to exist for the S.R.L./B.V. and is replaced by the concept of "equity." Equity consists of (i) the contributions of shareholders (formerly labeled "share capital"), (ii) reserves (retained earnings), and (iii) income (profit) carried forward that serves as protection for creditors (formerly labeled "legal reserve"). For the S.A./N.V., the terminology "capital" remains applicable.

21 Article 202, ¶2, first limb, 1° I.T.C.

<u>Announced New Rule:</u> The alternative threshold for the required tax book value of a participation will be increased to €4.0 million. According to the Belgian Government Agreement, an exception to this threshold will be provided for small and medium-sized enterprises.

Additionally, the introduction of an additional condition for the application of the D.R.D. has been proposed. Specifically, the participation would be required to be recorded by the corporate shareholder as a financial fixed asset, not as a portfolio investment. This additional requirement will only apply if both of the following conditions are met: (i) the participation has a value of at least €4.0 million and (ii) both the distributing company and the corporate shareholder qualify as large enterprises, meaning that S.M.E.'s are excluded.

- **Minimum Holding Period:** The recipient holds (or has committed to hold) the minimum participation referred to in the previous bullet in full ownership[22] for an uninterrupted period of at least one year prior to (and/or following) the dividend distribution.[23]

- **Subject to Comparable Tax Test:** The subsidiary making the dividend payment is subject to Belgian C.I.T. or a foreign tax similar to Belgian C.I.T.[24]

The Bills contain the requirement that shares must be recorded as financial fixed assets but do not contain the increase of the required tax book value of a participation from €2.5 million to €4.0 million. It is currently unclear whether this increase will be implemented in a later stage or not.

22 A *usufruct* right over the shares does not suffice. A *usufruct* right arises when full legal ownership to an asset is divided between bare legal ownership (a capital or remainder interest) and ownership of a current right to income or use. The latter is the *usufruct* right. The right exists for a limited period of time and is separate from the capital interest.

23 Article 202, ¶2, first limb, 2° I.T.C.

Announced New Rule: A third amendment to the D.R.D. regime will apply to dividends stemming from a participation in an investment company. A 5% tax will be imposed on the capital gain upon exit. In addition, the credit for dividend withholding tax will be disallowed, except when the investor company employs at least one director or manager and the annual compensation paid to at least one of the directors or managers is at least €50,000 in the taxable period in which the dividend is declared. The base amount of €50,000 in compensation will be indexed for inflation.

24 Article 203, ¶1, first limb, 1° I.T.C.

A foreign tax is not considered similar if the nominal or effective rate of tax is below 15%. The taxpayer may rebut this presumption.[25]

Tax regimes of all E.U. jurisdictions are deemed to be similar to Belgian C.I.T. even if the nominal or effective tax rate is below 15%.[26] Examples of countries benefiting from this rule are Ireland and Cyprus.

In contrast, countries appearing on the E.U. list of noncooperative jurisdictions will be deemed to not have a tax regime similar to Belgian C.I.T.[27] For 2025, this list includes the following 11 jurisdictions: American Samoa, Anguilla, Fiji, Guam, Palau, Panama, Russia, Samoa, Trinidad & Tobago, the U.S. Virgin Islands, and Vanuatu. Antigua & Barbuda was removed from this list on October 8, 2024.

Likewise, the Royal Decree implementing the I.T.C. ("R.D./I.T.C.") contains a list of 31 jurisdictions that are presumed not to have a tax regime similar to Belgian C.I.T.[28] Currently, this list includes the following jurisdictions:

Abu Dhabi	Maldives
Ajman	Marshall Islands
Andorra	Micronesia
Bosnia & Herzegovina	Moldova
Dubai	Monaco

25 Article 203, ¶1, second limb I.T.C.

26 Article 203, ¶1, third limb I.T.C.

27 Article 203, ¶1, first limb, 1°, *in fine* I.T.C.; See "Annex I – E.U. list of noncooperative jurisdiction for tax purposes" to the E.U.'s Council conclusions on the revised E.U. list of noncooperative jurisdictions for tax purposes, approved by the Ecofin Council at its meeting on February 18, 2025.

28 Article 73[4quater] R.D./I.T.C.

East Timor	Montenegro
Gibraltar	Oman
Guernsey	Paraguay
Isle of Man	Qatar
Jersey	Ras al Khaimah
Kosovo	Serbia
Kuwait	Sharjah
Kyrgyzstan	Turkmenistan
Liechtenstein	Umm al Qaiwain
Macau	Uzbekistan
Macedonia	

Countries appearing on this R.D./I.T.C. list may still pass the subject-to-tax test if the taxpayer is able to rebut the presumption. For example, due to the recent increase of the C.I.T. rate to 15% in Serbia, taxpayers may argue that Serbian-source dividends qualify for the D.R.D. despite appearing on the list.[29]

- **Specific Anti-Abuse Rule:** The D.R.D. is not available for dividends stemming from a company that distributes income related to a legal act or a series of legal acts that the Belgian tax authorities have determined are not genuine, and have as their main goal or one of their main goals the attainment of the deduction or one of the benefits of the P.S.D. in another E.U. Member State.[30] The determination is to be based on all relevant facts, circumstances, and proof to the contrary. Actions will be considered "not genuine" if they are not taken for valid commercial reasons that reflect economic reality. This rule is separate from Belgium's general anti-abuse provision.

The minimum participation value and minimum holding period requirements do not need to be fulfilled with respect to shares held in or by investment companies and regulated real estate

---

[29] See Ruling No. 2016.740 of November 29, 2016, available on www.monkey.be.

[30] Article 203, ¶1, first limb, 7° I.T.C.

companies.[31] Dividends and capital gains derived from these shares are fully exempt, irrespective of the size or duration of the investment, provided the subject to tax test is met.

c. Exceptions to the Participation Exemption

1) Finance, Treasury and Investment Companies

The D.R.D. is not available for dividends distributed by a finance company, a treasury company, or an investment company where the company enjoys a tax regime that deviates from the normal tax regime in its country of residence.[32]

A company is a finance company if its sole or principal activity consists of providing financial services to unrelated parties (*i.e.*, parties that do not form part of a group to which the finance company belongs).[33] Financial services include the provisions of financing and financial management. Belgian companies are part of the same group if one company exercises control over the others, if two companies are controlled by a common parent company, or if they constitute a consortium.[34]

A treasury company is a company that is principally engaged in portfolio investment other than cash pooling.[35]

---

31 Article 202, ¶2, third limb I.T.C.

32 Article 203, ¶1, first limb, 2° I.T.C.

33 Article 2, ¶1, 5°, d) I.T.C.

34 See Article 2, ¶1, 5°/1, which refers to Article 1:20 B.C.C.A.

35 Article 2, ¶1, 5°, e) I.T.C.

An investment company is a company whose purpose is the collective investment of capital funds.[36] Examples are companies that qualify as S.I.C.A.V.'s or S.I.C.A.F.'s.

Nonetheless, the D.R.D. is available under certain conditions for E.U.-based finance companies and for investment companies.[37]

2) Regulated Real Estate Companies

The D.R.D. is not available for dividends derived from a Belgian regulated real estate company, which is the functional equivalent of a real estate investment trust ("R.E.I.T.").[38] The same rule applies to a nonresident company if all of the following conditions are met:

- The main purpose of the company is to acquire or construct real estate property and make it available on the market or to hold participations in entities with a similar purpose.
- The company is required to distribute part of its income to its shareholders.
- The company benefits from a regime that deviates from the normal tax regime in its country of residence.

3) Offshore Activities

The D.R.D. is not available for dividends distributed by a company when the non-dividend income of that company originates in a third

---

36 Article 2, ¶1, 5°, f) I.T.C.

37 See Article 203, ¶2 I.T.C.

38 Article 203, ¶1, first limb, 2°*bis* I.T.C.; For further details on the tax regime of Belgian Regulated Real Estate Companies, see P. Desenfans and L. Pinte, "*Aspects fiscaux des SIR et FIIS,*" *Jurim pratique*, 2017/3, pp. 189-221.

country and such income is subject to a separate tax regime that provides more favorable results than the regular tax regime.[39]

4) Certain Foreign Branch Income

The D.R.D. is not available when the dividends are distributed by a company that realizes profits through a foreign branch that is subject to a tax regime substantially more advantageous than in Belgium.[40] This disallowance rule is, in turn, subject to an exception. The D.R.D. will be allowed for dividends distributed by (i) Belgian companies with foreign branches and (ii) companies established in certain treaty jurisdictions but operating through a branch in a third country.

Dividends stemming from non-Belgian branch profits qualify for the D.R.D. to the extent that either the branch profits are subject to a 15% foreign income tax, or the branch is located in another E.U. jurisdiction.[41]

5) Intermediate Companies

Subject to a 10% *de minimis* rule, the D.R.D. is not available for dividends distributed by an intermediate company, other than an investment company, that redistributes dividend income derived from tainted participations.[42] As a result, if more than 10% of a dividend received from an intermediate company is funded by the receipt of dividends from its subsidiaries located in third countries, the D.R.D. may be disallowed if the D.R.D. would not have been permitted had the lower-tier companies paid dividends directly to the Belgian company. In other words, a group cannot cleanse tainted dividends by "washing" them through an intermediary located in an acceptable jurisdiction.

---

39 Article 203, ¶1, first limb, 3° I.T.C.

40 Article 203, ¶1, first limb, 4° I.T.C.

41 Article 203, ¶2, seventh limb I.T.C.

42 Article 203, ¶1, first limb, 5° I.T.C.

As a safe harbor, participations in companies (i) residing in a country with which Belgium has concluded an income tax treaty or (ii) that are listed on a recognized E.U. stock exchange are in principle eligible for the D.R.D.[43] These companies must also be subject to a tax regime comparable to the Belgian tax regime, without benefiting from a regime that deviates from the normal tax regime.[44]

With respect to investments in a second-tier subsidiary through a hybrid entity such as a U.S. limited liability company ("L.L.C."), the Belgian Ruling Committee issued several favorable rulings. In most instances, the Ruling Committee confirmed that, for Belgian tax purposes, one can look through a foreign hybrid entity to allow the D.R.D. as if the underlying participation in a lower-tier company were held directly by the Belgian holding company. Thus, for example, in a ruling dated February 12, 2019, the Ruling Committee found that a Belgian company was entitled to the D.R.D. with respect to dividends received from a U.S. L.L.C.[45] The Ruling Committee looked to paragraph 1(b) of Article 22 (Relief From Double Taxation) of the Belgium-U.S. Income Tax Treaty and ruled that the Belgian company was entitled to the D.R.D. to the extent that such dividends stemmed from dividends received by the L.L.C. from a U.S. operating corporation that was subject to full corporate income tax in the U.S.

In the same ruling, the Ruling Committee confirmed that the proceeds of a redemption of capital that is received by an L.L.C. and in turn distributed to a Belgian company was plainly exempt from Belgian C.I.T. by virtue of Article 18, second limb, I.T.C. when the underlying U.S. company owned by the L.L.C. is subject to full tax in the U.S. Article 18 I.T.C. defines the term "dividend." Excluded from the scope of that definition is any return of share capital, provided the corporation that makes a distribution in return of share capital complied with the relevant company law rules. No

43 Article 203, ¶2, eighth limb, 1° I.T.C.

44 Article 203, ¶3 I.T.C.

45 Ruling No. 2018.0085 of February 12, 2019, available on www.monkey.be.

requirement exists to test the quantitative or qualitative conditions of the D.R.D. under Belgian domestic law or an income tax treaty.[46]

6) Dividend Payments that are Deductible for the Payor

The D.R.D. is not applicable to dividend income received from a company that has deducted or can deduct such income from its profits.[47]

7) Ruling Practice

Upon a taxpayer's request, the Belgian Ruling Committee may issue an advance tax ruling on various items such as the availability of the D.R.D., the capital gains exemption, the application of anti-abuse provisions and the qualification of a company as resident or nonresident taxpayer. Although a ruling is not mandatory, it is frequently used by multinational groups to obtain legal certainty.

In theory, the Ruling Committee issues the ruling within three months following the receipt of a complete ruling application. In practice, however, the actual term is assessed on a case-by-case basis within 15 days following the filing of the ruling application.

Subject to conditions, a ruling is valid for a maximum of five years. If justified, a ruling can be granted for a longer period. Rulings can also be renewed.

---

46 Note that under U.S. tax law, not all distributions that return share capital are treated as a redemption giving rise to capital gain treatment under U.S. tax law. Under Section 302 of the Internal Revenue Code, a distribution in return of capital – typically referred to as a redemption under U.S. tax jargon – is treated in some circumstances as a redemption and in others as a dividend. The key is whether the redemption results in a meaningful reduction in the ownership percentage held by the shareholder.

47 Article 203, ¶1, first limb, 5° I.T.C.

Effective May 2019, the Belgian Accounting Standards Committee issues rulings on the application of accounting law rules. In the absence of a tax rule that differs from an accounting rule, Belgian tax law follows Belgian accounting practice. It is understood that Belgian corporate income tax is based on the taxpayer's Belgian G.A.A.P. accounts, even if the taxpayer is part of a group filing consolidated accounts under I.F.R.S. (or any other set of consolidation rules). The availability of accounting law rulings may prove useful in practice.

d. Taxation of Dividends Received in a Year Having Operating Losses

Prior to assessment year 2009, if a Belgian company's activities other than serving as a holding company for its subsidiaries resulted in a loss in the current year, the loss was used to offset dividend income. As a result, the benefit of the loss carryover was reduced or even completely eliminated. Moreover, the unused portion of the D.R.D. was permanently lost.

This position was challenged in an appeal to the European Court of Justice ("E.C.J.") in *Cobelfret v. Belgium* (Case C-138/07).[48] On February 12, 2009, the E.C.J. concluded that Belgium failed to refrain from taxing qualifying dividends, as is required under Article 4(1) of the E.U. P.S.D. Two other cases were decided by "reasoned order" of the E.C.J. on June 4, 2009.[49] These cases dealt with E.U.-source dividends, Belgian domestic dividends, and dividends from countries outside of Europe. The E.C.J. asked the national courts to decide whether discrimination existed in the treatment of nonresident taxpayers when compared with resident taxpayers. This triggered an amendment to the statute by the Law of December 21, 2009, effective January 1, 2010. The net effect is that the unused portions of the D.R.D. can be carried forward for use in future tax years if, at the time the dividend is declared, the dividend

---

48 E.C.J., *Belgische Staat v. Cobelfret N.V.*, Case C-138/07, February 12, 2009, available at http://www.curia.europa.eu.

49 E.C.J., *Belgische Staat v. KBC Bank N.V. and Beleggen, Risicokapitaal*, Joined Cases C-439/07 & C-499/07, June 4, 2009, available at http://www.curia.europa.eu.

distributing company is established in any of the following jurisdictions:

- A Member State of the European Economic Area ("E.E.A."), including Belgium

- A country with which Belgium has concluded a tax treaty that contains an equal treatment clause (functional equivalent of Article 22(1)(c) of the Belgium-U.S. Income Tax Treaty currently in effect)

- Another country, provided that Article 63 of the Treaty on the Functioning of the European Union ("T.F.E.U.") (free movement of capital) applies to the capital represented by the shares that produce the dividends

Non-E.E.A. source dividends remain unaffected by the E.C.J. *Cobelfret* case. Consequently, the unused portion of the D.R.D. cannot be carried forward.[50]

In addition, Belgium disallows the D.R.D. to the extent that a Belgian company's taxable income (*i.e.*, profit) reflects certain nondeductible expenses.[51] However, the disallowance does not apply to dividends stemming from qualifying subsidiaries established in a Member State of the E.E.A.[52]

Where the facts of a particular case involving dividends from a company meet none of the foregoing criteria, the law remains unfavorable for taxpayers. According to a ruling of February 1, 2011, from the Court of First Instance in Brussels,[53] the rule that excess dividends cannot be carried over if they stem from subsidiaries in non-E.E.A. countries with which Belgium does not

---

50 Article 205, ¶3, *a contrario* I.T.C.

51 Article 205, ¶2, first limb I.T.C.

52 Article 205, ¶2, second limb I.T.C.

53 Court of First Instance in Brussels, February 1, 2011, R.G. 2009/1652/A, available on www.monkey.be.

have an income tax treaty in force containing an equal treatment provision does not run afoul of the Belgian constitutional nondiscrimination rule.

In the facts addressed by the Brussels Court, the Revenue Service allowed a taxpayer to carry over excess dividends from a Japanese subsidiary of a Belgian holding company because an equal treatment provision is provided in Article 23(2)(a) of the Belgium-Japan Income Tax Treaty. However, the Revenue Service refused to allow the carryover of Taiwanese and South Korean dividends, because the treaties with those jurisdictions did not contain an equal treatment clause. Before the Brussels Court, the taxpayer claimed that the foregoing distinction ran afoul of the Belgian nondiscrimination rule of Article 10 in conjunction with Article 172 of the Belgian Constitution. However, the Tribunal sided with the Revenue Service, concluding that the distinction between an E.E.A.-source dividend and a "third country dividend" is based upon an objective criterion, and is permissible for that reason.

In a similar case decided on October 10, 2012, the Belgian Constitutional Court confirmed that the carryforward or denial of the participation exemption for excess dividends from companies organized in third countries not having bilateral tax treaties with equal treatment clauses does not constitute a violation of the constitutional nondiscrimination principle.[54]

In sum, the unused portion of D.R.D. for E.E.A. source dividends can be carried forward following the E.C.J.'s *Cobelfret* case discussed above. Conversely, the D.R.D. for non-E.E.A. source dividends remain subject to the following double restriction:

- The D.R.D. cannot apply to certain nondeductible expenses (*e.g.,* the nondeductible portion of restaurant expenses).[55]

---

54 Belgian Constitutional Court, October 10, 2012, R.G. 118/2012, available at http://www.const-court.be.

55 See Article 205, ¶2, first limb I.T.C. for the complete list.

- The unused portion of the D.R.D. cannot be carried forward.[56]

Say a Belgian company ("BelCo") has (i) a non-E.E.A. source dividend of €50, (ii) a current year loss of €20, and (iii) nondeductible restaurant expenses of €10.

Before applying the D.R.D., the taxable base of BelCo is €40 (50-20+10). If the dividend of €50 meets the conditions for the D.R.D., the D.R.D. will apply only to €30 (40 of net income - 10 of nondeductible expenses), leaving a taxable base of €10 (40-30).

The unused portion of the D.R.D. (50-20 = 30) will be forfeited, as the dividend is from a non-E.E.A. source and thus cannot be carried forward, unless the dividend stems from a participation based in a country having a bilateral treaty in force with Belgium and which contains an equal treatment clause.

v. <u>Taxation of Capital Gains on Shares</u>

a. <u>Taxation of Realized Capital Gains on Shares</u>

Capital gains on shares realized by a Belgian company are in principle taxed as ordinary profits and subject to the standard 25% C.I.T. rate or the reduced rate of 20% for the first €100,000 of taxable income, if applicable.

By way of exception, a full exemption is applicable provided that the participation, holding period and subject-to-tax requirements applicable for the D.R.D. are met (see conditions above).[57] The exemption applies only to the net gain realized, *i.e.*, the amount after

---

56 Article 205, ¶3, *a contrario* I.T.C.

57 Article 192, ¶1 I.T.C.; The minimum participation requirement does not apply to insurance and reinsurance companies that hold participations to hedge their liabilities.

the deduction of the alienation costs (*e.g.*, notary fees, bank fees, commissions, publicity costs, consultancy costs, etc.).[58]

The fact that, as of assessment year 2019 (accounting years ending on or after December 31, 2018), the capital gain exemption is fully synchronized with the D.R.D. has important consequences in the following cases:

1) **<u>The "One Taints All" Principle</u>**

Prior to assessment year 2019, capital gains on the disposal of a share package containing a tainted share (*i.e.*, a share that did not qualify for the D.R.D.) were not exempt. After the reform, it is clear that a proportional exemption is possible, similar to the rules for the D.R.D.

2) **<u>Disposal of Part of a Qualifying Participation</u>**

Assume that a taxpayer has a qualifying participation of more than 10% or €2.5 million and that only a part of that participation is sold or otherwise disposed of. Any gain on this sale qualifies for the capital gain exemption.

However, it is not entirely clear whether the exemption will be available when the remainder of the participation is sold at a later time. If the remaining shareholding has an historic book value of at least €2.5 million or constitutes a participation of at least 10%, the exemption should be available. On the other hand, if the remaining shareholding has dropped below both the 10% and the €2.5 million thresholds, any gain on the sale of the remaining shareholding will likely fail the minimum participation test and, therefore, not be exempt.

3) **<u>Exchange of Shares</u>**

Subject to certain conditions, when a Belgian company transfers shares in a Belgian or European target company to a European acquiring company in exchange for issuance of new shares of the

---

[58] Article 43 I.T.C.

acquiring company, any gain resulting from the share-for-share exchange is temporarily exempt under the E.U. Merger Directive by virtue of a roll-over rule. As a result, it is possible in principle to exchange tainted shares for untainted shares. After the exchange, a company could request the exemption for capital gains on shares as described above. To stop this practice, the Belgian legislature has implemented a specific anti-abuse provision limiting the exemption to the capital gains that accrue after the exchange of shares. This provision applies only to shares that do not meet the valuation standard for exemption. Why the holding and/or participation requirements are not also subject to this provision is unclear and may lead to its improper use.

4) <u>Minimum Requirements</u>

The minimum participation requirements that exist for dividends – ownership of 10% of the capital, or an acquisition value of the shareholding of not less than €2.5 million – also apply to capital gains.[59]

In the past, uncertainty existed regarding the D.R.D. where the shares were acquired by a Belgian holding company at a price or value that was far below their actual value at the time of acquisition. The position of the Belgian Revenue Service was that the difference between the artificially low acquisition price and the high actual value as of the date of acquisition should be booked as an undervaluation of assets and taxed as regular income of the holding company. The income would be deemed to accrue in the year of acquisition. It would be taxed retroactively at the full C.I.T. rate of 25%.

This position was successfully challenged in the *Gimle* case[60] in a preliminary ruling from the E.C.J. that was settled definitively by

---

59 See Article 192, ¶1 I.T.C, which refers back to Articles 202-203.

60 E.C.J., *Belgium v. Gimle S.A.*, Case-322/12 of October 3, 2012, ECLI:EU:C:2013:632, spec. ¶39.

the Court of Cassation.[61] Going forward, the full gain based on the low purchase price is exempt.

5) Operation of the Capital Gains Exemption

The capital gains exemption is granted by a direct elimination of the net gain from taxable income. Consequently, loss utilization is not adversely affected.

Losses derived from other activities of the Belgian holding company, including interest and other costs or expenses related to the acquisition of the participation, are not allocated to the exempt gain.

This treatment should be compared to the treatment of costs and expenses relating to the sale of shares. This is discussed below.

6) Options

If a Belgian company purchases stock below fair market value pursuant to the exercise of a call option or a warrant, any subsequent gains realized upon the disposition of the shares of stock qualify in principle as fully exempt capital gains, provided all conditions provided in Belgian law are met. The exemption does not apply to gains derived from the sale of the option or the warrant as such. If the call option itself were sold at a gain reflecting the appreciation of the value of the underlying share, the gain would be subject to the regular C.I.T. rate.

Note, however, that the law of December 1, 2016, introduced specific anti-abuse provisions applicable to the D.R.D., the capital gains exemption, and the W.H.T. exemption for parent companies. These rules are in addition to Belgium's general anti-abuse provision. Transposing the revisions to the P.S.D. issued by the European Commission ("Commission"), taxpayers must have

[61] Court of Cassation, May 16, 2014, R.G. F.10.0092.F., available at www.monkey.be.

appropriate business motives for the implementation of a holding structure, as previously discussed.

b. Taxation of Unrealized Capital Gains on Shares

Unrealized capital gains are not taxable if the capital gains are not reflected in the company's financial accounts. There are no mark-to-market rules under Belgian G.A.A.P. Even if reported, the unrealized gain is not taxable if and as long as it is booked in a non-distributable reserve account.[62] Upon later realization of the gain, the non-distributable reserve account disappears without triggering C.I.T., assuming all conditions for the capital gains exemption are met at that time.

c. Taxation of Realized and Unrealized Capital Losses on Shares

Capital losses on shares, whether realized or unrealized, are not tax deductible.[63] However, the loss incurred in connection with the liquidation of a subsidiary company remains deductible up to the amount of lost paid-up share capital.

The nondeductible nature of a capital loss is limited to shares. Capital losses realized on other securities (*e.g.,* bonds) or derivatives (*e.g.,* options) are fully tax deductible.

B. Withholding Tax on Dividend Distributions

i. To Belgium

Dividends distributed by a non-Belgian company to a Belgian company may be subject to dividend W.H.T. at the rate in effect in the country of residence of the company paying the dividend. In most situations, this rate is reduced or eliminated by a tax treaty or the P.S.D.

---

62 Article 24, first limb, 2° I.T.C. read in parallel with Article 44, ¶1, 1° and 190, second and fourth limbs.

63 Article 198, ¶1, 7° I.T.C.

With the exception of investment companies, Belgium's national law does not grant a tax credit for foreign W.H.T. imposed on dividends.[64] However, certain bilateral tax treaties provide a Foreign Tax Credit ("F.T.C.") trumping the Belgian national law provisions. For instance, the Belgian Court of Cassation ruled on October 15, 2020, that the Belgian Revenue Service cannot invoke national provisions to deny Belgian taxpayers the benefit of the 1964 Belgium-France tax treaty.[65]

ii. From Belgium

a. General Rule

As a general rule, dividends distributed by Belgian companies to resident and nonresident shareholders are subject to 30% Belgian dividend W.H.T.[66] Under specific circumstances, reduced rates or exemptions are available.

A full exemption of Belgian dividend W.H.T. applies on the payment of dividends to a parent company established within the E.E.A. (including Belgium) or in a country with which Belgium has concluded a tax treaty containing an exchange of information provision.[67] In both instances, the shareholder must hold (i) a

---

64 Article 285, second limb I.T.C.

65 Court of Cassation, October 15, 2020, R.G. F.19.0015.F, *F.J.F.*, 2020/10, pp. 365-366; Note that Belgium has recently signed a new tax treaty with France on November 9, 2021. In this respect, see P.-J. Wouters, "The Belgium-France Income and Capital Tax Treaty (2021): What's New?" *Bulletin for International Taxation*, 2022, Vol. 76, No 3, pp. 159-167.

66 Article 261, 1° I.T.C. and Article 269, ¶1, 1° I.T.C.

67 Article 106, ¶¶5-6*bis* R.D./I.T.C.; The Belgian Revenue Service takes the view that the agreement between Belgium and Taiwan does not qualify as a tax treaty. Therefore, the full dividend W.H.T. exemption for dividends distributed by

participation of at least 10% of the Belgian-resident company or an acquisition price or value of at least €2.5 million and (ii) the participation must have been held for an uninterrupted period of at least one year, which may occur partly before and partly after the dividend distribution. Once a qualifying parent company holds a qualifying participation, all additional acquired shares also qualify, even if the one-year holding period is not met with respect to the additional shares.

b. Less-Than-10% Investments

Following the ruling from the E.C.J. in the *Denkavit* case,[68] Belgium abandoned the condition that the parent must have held a participation of at least 10% for an uninterrupted period of at least one year preceding the distribution of the dividend. Therefore, the parent may hold the 10% participation for one entire year, which may occur partly before and partly after the dividend distribution. If the one-year hurdle is not fully met at the time the dividend is paid, the Belgian distributing company is allowed to pay out the net dividend only (*i.e.,* the gross dividend minus an amount equal to the dividend W.H.T. that would apply if the one-year holding period is not respected, thereby taking into account any treaty-based reductions that would be available if the one-year holding period is not met), without an actual payment to the Belgian Revenue Service for the notional tax retained. If the shares are sold prior to meeting the holding period requirement, the amount of W.H.T. becomes due, increased by interest for late payment of tax. Otherwise, the

---

a Belgian company will not be available to the extent such dividends are distributed to a Taiwanese parent company.

68 E.C.J., *Denkavit Internationaal B.V. and Denkavit France S.A.R.L. v. France*, December 14, 2006, Case C-170/05, available at http://www.curia.europa.eu. Note that this is the second case involving the Denkavit company; the first one (C-283/94, October 17, 1996) also concerned the treatment of dividends, the application of the P.S.D. and the calculation of the two-year minimum holding period required to benefit from the participation exemption.

undistributed portion of the dividend can be distributed freely once the one-year holding requirement is met.

The exemption from dividend W.H.T. is subject to the conditions mentioned in the P.S.D. with respect to the legal form, E.U. tax residence, and the parent company's compliance with a subject-to-tax requirement.[69] As a result of the amendment of the P.S.D., several types of entities that were not eligible for the W.H.T. exemption now qualify, most notably the "European company" or "*societas Europaea*" ("S.E."). The legal form requirement does not apply if dividends are paid to Belgian entities subject to Belgian C.I.T.

Corporate investors established in other E.E.A. Member States would be subject to double taxation if they held a participation in a Belgian company that was less than 10% but had an acquisition price or value of at least €2.5 million. Under these circumstances, a Belgium-resident corporate shareholder would be entitled to the D.R.D., which amounts to 100% as of January 1, 2018, and be allowed a full credit and refund for Belgian dividend tax withheld at source. In comparison, prior to January 1, 2018, the €2.5 million threshold did not apply for the exemption from dividend W.H.T., meaning that a non-Belgian E.E.A. shareholder with an interest below 10% but an acquisition price or value of at least €2.5 million was subject to Belgian W.H.T. on any dividends received from its Belgian participation.[70] If the shareholder was not entitled to claim a foreign tax credit in its country of residence, the Belgian dividend was subject to double international taxation.

To remedy this unequal treatment, the Law of December 25, 2017, introduced a new dividend W.H.T. exemption. New Article 264/1 I.T.C. alleviates the participation requirement effective as of January 1, 2018. If the participation does not satisfy the 10% test, dividends

---

69 See Article 106, ¶5 R.D./I.T.C.

70 Since January 1, 2018, Article 264/1, ¶1, second limb I.T.C. allows non-Belgian E.E.A. shareholders with an interest below 10% but with an acquisition price or value of at least €2.5 million to benefit from a full dividend W.H.T. exemption.

can still be exempt from W.H.T. if the E.E.A.-based corporate shareholder owns a participation in the Belgian distributing company with a tax book value of at least €2.5 million for an uninterrupted period of at least one year (prior to and/or immediately after the distribution of the dividend).[71] To curb any potential abuses, the new exemption does not apply if, *inter alia*, the beneficiary of the dividend is entitled to credit Belgian dividend W.H.T. against its mainstream tax liability and receive a full refund of any excess W.H.T. in the E.E.A. Member State where it is based. In addition, the beneficiary must certify that it meets the other P.S.D. criteria, *e.g.*, that it has a legal form listed in the Annex to the P.S.D. and that it is subject to the normal C.I.T. regime in the other Member State.

This provision also introduces an exemption for Belgian companies distributing a dividend to a non-E.E.A. based shareholder who (i) is based in in a country with which Belgium has concluded a tax treaty containing an exchange of information provision and (ii) owns a participation below 10% in the Belgian company but with an investment price or value of at least €2.5 million.

c. Liquidation/Redemption Distributions to Persons Not Entitled to the Participation Exemption

The W.H.T. rate is set at 30% if dividends result from a redemption of shares or a share buy-back.

Distributions pursuant to liquidations and redemptions are subject to 30% Belgian dividend W.H.T., but may be eligible for rate

---

71 **Announced New Rule**: The Bills contain the requirement that shares must be recorded as financial fixed assets for applying the W.H.T. exemption for foreign corporate shareholders holding a participation of less than 10% in a Belgian company, provided the acquisition value is at least €2.5 million. To qualify for the W.H.T. exemption, foreign shareholder companies must submit a written attestation to the Belgian company distributing the dividend, confirming that the participation is recognized as a financial fixed asset in their commercial books.

reductions or exemptions from W.H.T. under a tax treaty concluded by Belgium, the P.S.D., or the unilateral extension of the P.S.D. W.H.T. exemption discussed above.

Through December 2017, any repayment of share capital or share premium to the shareholders was exempt from dividend W.H.T., provided that the repaid capital consisted of paid-up fiscal capital, did not consist of reserves, and the reduction of capital was executed in accordance with the old Belgian Company Law Code (now replaced by the B.C.C.A.).

In order to combat certain abusive "step-up" structures, the Law of December 25, 2017, introduced a relatively complex set of rules governing the reduction and reimbursement to shareholders of fiscal share capital.[72] From January 1, 2018, any reduction of share capital, including qualifying share premium, will be deemed to be paid proportionally from (i) fiscal share capital and share premium and (ii) profits carried forward or retained earnings. Only insofar as the capital reimbursement is deemed to be paid from fiscal share capital and share premium will no dividend W.H.T. apply. The portion of such reimbursement that is deemed to stem from profits carried forward and retained earnings will be treated as a regular dividend subject to the rules for regular dividend distributions, as discussed above.

iii. <u>Abuse of European Union's Directives</u>

In February 2019, the E.C.J. ruled in the so-called *Danish cases* (Joined Cases C-116/16 and C-117/16) that the explicit transposition of the anti-abuse provisions of the E.U. Directives into national legislation or income tax treaties is not necessary to deny the

---

72 Fiscal share capital is any portion of a company's equity that stems from actual contributions in cash or in kind made to the company by its current or past shareholders. It excludes any earnings and profits of the company that were converted to share capital for legal and accounting purposes but did not stem from contributions made by shareholders.

benefits of these Directives in abusive situations.[73] For the E.C.J., there is, *inter alia*, an indication of abuse when

- the recipient lacks substance, has no other economic activity in the country or has been interposed in a structure that otherwise would not be covered by the E.U. Directives, or

- the funds are passed on shortly after they are received, which indicates that the entity might be a mere flow-through or conduit to the ultimate recipient.

In December 2020, the Belgian Court of Appeals of Ghent endorsed the E.C.J.'s Danish cases doctrine and earmarked as abusive a W.H.T. exemption applied by a Belgian company distributing dividends to a Luxembourg S.P.V., because of the lack of substance in Luxembourg in combination with the artificial character of a number of steps in the transaction that was at stake.

On November 30, 2023, the Court of Cassation confirmed this ruling from the Ghent Court of Appeals and took the position that the Revenue Service and Belgian courts can rely on the general E.U. anti-abuse principle to establish tax abuse, even in the absence of a specific domestic beneficial ownership test or a general anti-abuse rule under domestic law. It is particularly noteworthy that the Court found that the general E.U. anti-abuse principle can be used by the Revenue Service to attack legal acts predating the Danish cases (2019). The Court of Cassation further held that, unless expressly required by domestic law, the status of beneficial ownership is not an absolute or autonomous prerequisite for claiming a W.H.T

---

[73] For further details about the Danish cases, see W. Heyvaert et *al.*, "Economic Substance: Views From the U.S., Europe, and the B.V.I., Cayman and Nevis," *Insights* Vol. 10, No. 3 (2023), pp. 5-27, spec. pp. 16-19 (available at https://publications.ruchelaw.com/news/2023-05/EconomicSubstance.pdf); see also S. Baerentzen, "Danish Cases on the Use of Holding Companies for Cross-Border Dividends and Interest – A New Test to Disentangle Abuse from Real Economic Activity?" *World Tax Journal*, 2020, Vol. 12, No 1, pp. 3-52.

exemption. While the absence of beneficial ownership status does not in and of itself constitute tax abuse, it is considered a significant indicator of potential abuse.

The Court also clearly outlined the criteria to establish tax abuse. For tax abuse to be present, the Revenue Service must demonstrate that both the objective and the subjective conditions are met. This implies that a taxpayer can counter allegations of tax abuse by applying a "lookthrough approach." Specifically, the "subjective element" of tax abuse is not met if the taxpayer can prove that a W.H.T. exemption would have been granted even if the income had been paid directly to the beneficial owner, without the interposition of an intermediary or "interposed entity."

C. Tax Treatment of Borrowing and Interest Payment

In principle, interest expense incurred by a company is tax deductible. However, limitations apply to the deduction.

i. General Expense Deduction Rule

Like other costs and expenses, interest expenses are deductible by a company to the extent any of the following factors exists:[74]

- They relate to the company's business activities.
- They are incurred or borne during the taxable period.
- They were incurred with a view to producing or maintaining taxable income.
- They are subject to proper documentation being provided.

ii. General Interest Limitation Rule (Arm's Length Principle)

Companies can deduct interest expenses to the extent they correspond to a market interest rate, taking into account the specific

74 Article 49 I.T.C.

characteristics of the financing.[75] These include the currency exchange risk, the debtor's credit rating or creditworthiness, the duration of the loan, the timing of interest payments, the reimbursement of principal, and any collateral held as security by the lender.

If the interest charged between two related parties exceeds the interest charged in a comparable transaction between two unrelated parties, any excessive interest payment is not tax deductible by the borrower. If excessive interest paid or accrued by the borrower is not reported in the company's annual C.I.T. return, but rather added to its tax base as a result of a tax examination by the Belgian Revenue Service, the excessive interest deduction will be earmarked as an "abnormal or gratuitous advantage" and taxed currently without being eligible for a set-off by reason of a loss that is available for carryover from an earlier year or other deductions.[76]

iii. <u>Interest Payments to Tax Exempt/Low Taxed Non-E.U. Residents</u>

If a Belgian company pays interest to a nonresident who is either not subject to tax or who benefits from a tax regime notably more advantageous than the Belgian tax regime, such interest would not be tax deductible unless and to the extent the Belgian company can demonstrate that the interest payment (i) does not exceed the normal limits, *i.e.,* the interest rate is at arm's length and (ii) relates to real and sincere operations, *i.e.,* the loan is neither fictitious nor simulated and is entered into for genuine business, commercial or financial purposes.[77]

It is not required that the borrower has a need to borrow; the borrower is free to choose how it finances its business with shareholder equity, related party debt, or third-party debt. However,

---

75 Article 55 and 56 I.T.C.

76 Article 206/3, ¶1 I.T.C.

77 Article 54 I.T.C.

the borrower has the burden of demonstrating that the two conditions set forth above are met.

In principle, this rule is applicable to interest paid by Belgian companies to any nonresident who is exempt from tax or subject to a beneficial tax regime on the interest earned. However, in the *S.I.A.T.* case (C-318/10), the E.C.J. ruled that this rule infringes the European freedom to provide services, to the extent the application of the rule treats (i) interest paid to Belgian residents more favorably – not subject to the reversal of burden of proof-rule – than (ii) interest paid to other E.U. residents – subject to the reversal of burden of proof-rule.[78] As a result, it is generally understood that the two-prong rule described above, including the burden of proof element, applies only to interest paid or owed to non-E.U. residents.

Another rule provides that interest paid by Belgian companies to a recipient established in a jurisdiction listed as a tax haven for Belgian tax purposes would be tax deductible only to the following extent:[79]

- The Belgian company establishes that the interest relates to "genuine and sincere operations" (as defined above) with persons other than artificial constructs.

- The Belgian company reports the payment in an annex to its C.I.T. return.

This rule does not apply in two instances. The first is that the payment does not exceed €100,000 for a taxable period. The second is that the interest is paid to a non-E.U. person resident in a state with which Belgium has signed an income tax treaty containing a nondiscrimination clause or an automatic exchange of information clause.

---

78 E.C.J., *S.I.A.T. v. Belgium*, July 5, 2012, Case C-318/10, available at www.curia.europa.eu.

79 Article 198, ¶1, 10º I.T.C.

iv. E.B.I.T.D.A. Limitation Rule

a. In General

Belgium implemented Article 4 of the E.U. Anti-Tax Avoidance Directive ("A.T.A.D.") into its national law. Therefore, companies are allowed to deduct excess borrowing cost only to the extent it does not exceed a cap.[80] Excess borrowing cost refers to an entity's net funding cost, consisting of the difference between interest paid or accrued under its accounting method over interest received or accrued and recognized under its accounting method.[81] The excess borrowing cost is capped at €3 million or 30% of the E.B.I.T.D.A. computed for income tax purposes, whichever is greater. The cap is referred to frequently as "fiscal E.B.I.T.D.A."

b. Fiscal E.B.I.T.D.A.

The computation of fiscal E.B.I.T.D.A. begins with taxable profit. After that, several tax-technical corrections are made, which can be divided into two groups. The first group of corrections adds back to the taxable profit amortization deductions, depreciation deductions, and the amount of excess interest expense over interest income.[82] The second group of corrections removes, *inter alia*, income to which the D.R.D., the I.I.D., or an F.T.C. applies, the intragroup profit transfer (the so-called "Group Contribution"), or the profit relating to a qualifying long-term public infrastructure project.[83]

---

80 Article 198/1 I.T.C.

81 See Article $73^{4/8}$ R.D./I.T.C. that provides a description of income and expenses that are "economically equivalent to interest," *e.g.,* payments under profit participation loans, capitalized interest, foreign exchange gains/losses related to interest payments, guarantee provisions, discount on interest-free or abnormally low-interest loans.

82 Article 198/1, ¶3, second limb I.T.C.

83 Article 198/1, ¶3, third limb I.T.C.

This reflects the view that exempt income is removed when computing fiscal E.B.I.T.D.A.

c. Exclusions

The fiscal E.B.I.T.D.A. limitation rule for interest expense deductions does not apply to any of the following:

- Income from financial operations of banks, insurance companies, pension funds, leasing companies, and factoring companies

- Income of standalone entities, essentially taxpayers without a foreign P.E. and without affiliates having a direct or indirect shareholding link of at least 25%

- Public-private partnership projects, essentially long-term public infrastructure projects

The following three types of loans are also out of scope:

- Loans concluded before June 17, 2016, unless fundamental changes have been made to the terms and conditions after that date[84]

- Loans in relation to public-private cooperation projects

- Loans between Belgian entities that are part of the same group, as discussed in more detail, below

[84] These grandfathered loans remain subject to the old Belgian 5:1 thin capitalization rule, under which interest payments or attributions in excess of a 5:1 debt-equity ratio are not tax deductible.

d. Carryforward

Taxpayers can carry forward the excess borrowing costs that cannot be deducted during a financial year to a subsequent financial year or transfer them to another Belgian group entity.[85]

e. Group Application

Belgian entities that are part of a group must share the interest deduction cap among themselves.[86] The allocation may be computed on a per capita basis among all members or in proportion to the level of the respective excess borrowing costs of each member. In the latter instance, a complex four-step approach must be applied when calculating fiscal E.B.I.T.D.A. of the group and its members.

If the overall E.B.I.T.D.A. of a Belgian group is less than €10 million, group entities may collectively waive their right to determine their individual E.B.I.T.D.A. in a specific tax form (275 CRC) that that is part of the C.I.T. return.[87] In such a case, the interest capacity depends only on the €3 million threshold.

v. Interest on Debt Pushdowns Payable at Redemption

Interest must be related to the conduct of a business in order to be deductible.[88] That is not clearly the case when the underlying debt is incurred in either of the following fact patterns:

---

85 Article 194*sexies* I.T.C.; For further details, *see* M. Possoz and B. Buytaert, "*De nieuwe EBITDA-interestaftrekbeperking*," *Tijdschrift voor Fiscaal Recht*, 2019/8, No 560, pp. 378-399.

86 Article 198/1, ¶3, third limb, first dash I.T.C.

87 Article 73$^{4/11}$, ¶3 and 73$^{4/12}$, ¶2 R.D. I.T.C.

88 Article 49 I.T.C.

- The proceeds of the borrowing are used to finance the acquisition of a qualifying participation in another company.[89]

- The proceeds of the borrowing are used to pay back equity or distribute dividends to the company's shareholders, as illustrated in the following case.

On May 8, 2018, the Court of Appeals in Antwerp handed down a remarkable ruling regarding the deduction of interest expense arising from a borrowing that was used to finance a redemption treated as a capital gain for the relevant shareholders.[90] The facts of the case are as follows:

- On July 1, 2012, a Belgian company ("BelCo") borrowed €450 million from its Belgian parent company ("Parent"), incurring interest expense computed at an arm's length rate.

- €350 million of the amount borrowed was used by BelCo to reimburse share capital to its shareholders, including Parent, and €100 million was used to pay an interim dividend to its shareholders, also including Parent.

- The capital reduction and the interim dividend payment were authorized by the shareholders prior to the loan agreement between BelCo and Parent.

- For tax assessment year 2013, BelCo claimed a deduction of €9,689,900 of interest expense owed to Parent.

---

89 Even though a participation in another company may result in a tax-exempt dividend income or capital gains only, it is generally accepted that interest incurred in connection with the financing or the acquisition of the participation is tax deductible.

90 Court of Appeals in Antwerp, May 8, 2018, R.G. 2016/AR/2108, available at www.monkey.be.

The Belgian Revenue Service challenged the deduction claiming it did not meet one of the essential requirements of Article 49 I.T.C. (see prior discussion of the general expense deduction rule), as it was not a cost or expense incurred to produce or maintain taxable income. The Court of Appeals in Antwerp sided with the Belgian Revenue Service, taking the view that the reduction and payback of share capital and distribution of dividends to shareholders is not automatically a cost or expense that was incurred to produce or maintain taxable income for BelCo. After having examined the facts at hand, the Court of Appeals ruled that the interest expense was not deductible. BelCo filed an appeal against this ruling with the Court of Cassation, the highest Belgian court in tax matters.

On March 19, 2020,[91] the Court of Cassation ruled on the matter by following the Court of Appeals in Antwerp and establishing that the tax deductibility of an interest accrual in these circumstances is not automatically excluded, but that the company must corroborate that the interest expense was incurred or borne to obtain or maintain taxable income. In this case, the taxpayer did not meet its burden of proof because the underlying documentation was apparently very meager and not very accurate. For example, the loan was made "for general corporate purposes." On March 23, 2023, the Court of Cassation held in a comparable case that the purpose of such loans was not to enable the distributing company to retain or generate taxable income, but rather to serve the interests of the shareholders.[92]

However, two recent rulings by the Ghent Court of Appeals[93] mark a turning point, accepting that the interest expense can be deducted if the taxpayer demonstrates that the loan allows the company to retain income-generating assets, thus meeting the deduction

91 Cass. March 19, 2020, F.19.0025.N/1, available at www.stradalex.com.

92 Cass. March 23, 2023, AR F.22.0071.N, available at www.monkey.be.

93 Ghent Court of Appeals, December 10, 2024, 2023/AR/901 and February 18, 2025, 2023/AR/1520, both available at www.monkey.be.

requirements. The Court clarified that the purpose of the interest expense – not the distribution itself – must be assessed. The Court emphasized that neither the expediency of the expense nor the application of the proceeds to fund a capital reduction or dividend distribution should be taken into account. The Court further stated that the capital reduction or dividend distribution being voluntarily committed to is irrelevant to the tax deductibility of the interest expense. The interest expense is deductible if the taxpayer can substantiate which assets were preserved and that these assets continue to generate taxable income for the distributing company (the so-called "asset stripping" theory). While these rulings are a positive development for taxpayers, the burden of proof remains high, and the risk of challenge persists, especially if the commercial rationale is not well documented.

vi. Special Fact Patterns related to Interest Expenses

a. Innovation Income Deduction

The innovation income deduction, or I.I.D., was introduced, based on the modified nexus approach recommended by the O.E.C.D. in B.E.P.S. Action 5. This regime was effective as of July 1, 2016.

The Act of December 19, 2023, "introducing a minimum tax for multinational companies and large domestic groups"[94] ensures that multinational groups or large domestic groups pay an effective 15% tax (see below). This minimum tax negates the tax benefit of the I.I.D. This is why the Act of May 12, 2024, containing various tax provisions, provides measures to safeguard the tax benefit of the I.I.D. Taxpayers can now opt to not deduct (part of) the I.I.D. but to convert it into a transferable, non-refundable tax credit, known as the I.I.D. "innovation income tax credit."[95]

Under the I.I.D. regime, a corporate taxpayer can deduct from the taxable base up to 85% of its net innovation income, resulting in an effective C.I.T. that can be as low as 3.75% (*i.e.,* 25% regular

---

94 Published in the Belgian Official Gazette on December 28, 2023.

95 Articles 205/1, 289decies and 292ter I.T.C.

Belgian C.I.T. rate multiplied by the remaining 15% of net innovation income).[96] The company can therefore choose to pay more corporate tax (by converting all or part of its I.I.D. into a tax credit) to avoid a top-up tax of up to 15%. The conversion into a tax credit is done at the corporate tax rate of 25%. The tax credit can be carried forward without any time limitation to financial years in which the effective tax rate would exceed 15%.

Income from copyrighted software is also eligible for the 85% deduction under the I.I.D. regime.[97]

vii. Withholding Tax on Outbound Interest Payments

In principle, interest paid by any Belgian company is subject to a W.H.T. of 30%.[98] Often, this domestic rate can be reduced by bilateral tax treaties, the E.U. Interest and Royalty Directive, and several domestic exemptions that have been implemented in Belgium. This will be the case if the Belgian company borrowed from an E.U.-affiliated company, a Belgian bank, a credit institution located in the E.E.A., or a lender resident in a tax treaty country. It applies also if the Belgian company issued registered bonds to nonresident taxpayers. In some cases, certificates must be filed alongside the W.H.T. return.

---

96 If, in the tax year for which the I.I.D. is claimed, insufficient taxable income is left to absorb the full amount of the I.I.D., any unused portion can be carried forward to subsequent tax years, with no time limit (Article 205/1, ¶1, second limb I.T.C.).

97 For further details, see W. Heyvaert, "Belgium's New Innovation Income Deduction Regime," *European Taxation*, 2018, Vol. 58, Issue 5, pp. 206-209.

98 Article 261, 1° I.T.C. and Article 269, ¶1, 1° I.T.C.

D. Capital Duty

Pursuant to the Law of June 23, 2005, the rate of capital tax is set at 0%[99] for all contributions to share capital occurring on or after January 1, 2006.

The contribution in kind of Belgian situs real estate may be subject to the real estate transfer tax (10% in Flanders; 12.5% in Brussels and Wallonia) to the extent the contribution is not made exclusively or entirely in return for shares of stock. A classic example is the contribution of real estate together with an existing mortgage loan that predates the contribution.

E. V.A.T.

On the basis of E.C.J. case law, a distinction is made between active and passive holding companies for purposes of V.A.T.[100] A passive holding company has no economic activity that gives entitlement to claim a credit for input V.A.T. Its activities consist exclusively of the collection of dividends as well as the realization of capital gains upon disposition of shares or participations. In comparison, an active holding company is involved in its subsidiaries' management in return for remuneration. To the extent that its activities are neither exempt nor outside the scope of V.A.T., an active holding company can credit input V.A.T. against output V.A.T.

Based on a response in 2010 of the Belgian Minister of Finance to a Parliamentary Question,[101] even V.A.T. incurred in connection with a sale of shares may be creditable and refundable, under appropriate circumstances. This insight is derived from the E.C.J.'s ruling

---

99 Technically speaking, the capital tax is not repealed, but its rate is set at 0%.

100 See *e.g.* E.C.J., *E.D.M. v Fazenda Pública*, April 29, 2004, Case C-29/08, available at http://www.curia.europa.eu.

101 Parl. Question, No. 299 of January 12, 2010, Brotcorne, *Q&A,* Chamber 2009-2010, No. 52-102, 107.

Skatteverket v. A.B. S.K.F.[102] First, one should determine whether there is in principle a direct relationship between a previous transaction, such as an input transaction on which input V.A.T. is chargeable, and a subsequent transaction, such as an output transaction that is subject to output V.A.T. If a relationship exists, the input V.A.T. can be credited by the holding company in computing its V.A.T. payments to the Belgian government. However, if there is a direct relationship between an input transaction and an output transaction that is either exempt from V.A.T. or outside the scope of V.A.T., the input V.A.T. is not creditable, as was the situation in E.C.J.'s ruling in *B.L.P. Group.*[103] Nonetheless, the input V.A.T. may still be creditable when the cost for the input services is part of the general expenses of the taxpayer and is included in the price charged by the taxpayer for goods delivered or services rendered to its affiliate. In essence, the parent can create its own connection by acts it takes and records it keeps.

This principle, too, was formulated in the *Skatteverket v. A.B. S.K.F.* case and the Belgian Revenue Service accepted that input V.A.T. could be creditable in the event of an issuance of new shares or the purchase of shares. However, V.A.T. credit is not available if the cost of the input transaction on which V.A.T. was charged is included in the sale price of the shares, which is either exempt or out of the scope of V.A.T. On May 3, 2018, the Advocate General of the E.C.J. clarified that V.A.T. incurred in connection with a failed sale of shares is fully deductible in the abovementioned circumstances.[104]

In addition, a holding company may merely manage certain participations while providing taxable services to other subsidiaries (a so-called "mixed holding company"). According to the E.C.J., a

---

102 E.C.J., *Skatteverket v. A.B. S.K.F.*, October 29, 2009, Case C-29/08, available at http://www.curia.europa.eu.

103 E.C.J., *B.L.P. Group P.L.C. v. Commissioners of Customs & Excise*, April 6, 1995, Case C-4/94, available at http://www.curia.europa.eu.

104 Opinion of Advocate General Kokott in E.C.J., *Ryanair L.T.D. v. The Revenue Commissioners*, October 17, 2018, Case C-249/17, available at www.curia.europa.eu.

mixed holding company that repeatedly interferes in the management of its subsidiaries may deduct the input V.A.T. paid on the procurement of consulting services for a market survey with a view to acquiring shares of another corporation, even if this acquisition did not ultimately take place.[105] A mixed holding company which repeatedly interferes in the management of its subsidiaries may not deduct the input V.A.T. paid on the commission paid to a credit institution for arranging a debenture loan for investments in a certain sector, when those investments did not ultimately take place and the capital thus raised was made entirely available to the parent company in the form of a loan. Consequently, actual use of the goods and services takes precedence over the original intention.

F. **<u>Private P.R.I.C.A.F./P.R.I.V.A.K.</u>**

Private P.R.I.C.A.F./P.R.I.V.A.K.'s are unlisted collective investment undertakings aimed at investing in unlisted companies. As such, a Private P.R.I.C.A.F./P.R.I.V.A.K. is not a holding company.

A Private P.R.I.C.A.F./P.R.I.V.A.K. can take the form of a company limited by shares ("S.A./N.V." or "S.R.L./B.V."). It is a closed-end fund, established by private investors, *i.e.*, persons investing at least €25,000 each.[106] The Private P.R.I.C.A.F./P.R.I.V.A.K. must have at least six private investors."

A Private P.R.I.C.A.F./P.R.I.V.A.K. exists for a period of 12 years. This period can be extended by the investors twice, each time for a period of three years. The extensions must be approved by 90% of the votes cast, representing at least 50% of the share capital.

Private P.R.I.C.A.F./P.R.I.V.A.K.'s may invest in a broad range of financial instruments issued by *unlisted* companies. This includes (i) shares, bonds, and debt instruments of all kinds; (ii) securities issued

---

105 E.C.J., *Sonaecom*, November 12, 2020, Case C-42/19, available at www.curia.europa.eu.

106 Note that the Royal Decree of May 8, 2018, decreased the minimum investment threshold from €100,000 to €25,000.

by other undertakings for collective investment; and (iii) derivative financial instruments such as subscription rights and options. Other investments are either partially or temporarily authorized or prohibited.

The Law of March 26, 2018, abolished a restriction that prohibited a Private P.R.I.C.A.F./P.R.I.V.A.K. from acquiring a controlling stake in a portfolio company.

Private P.R.I.C.A.F./P.R.I.V.A.K.'s must register with the Belgian Revenue Service. Furthermore, the Royal Decree of May 8, 2018, provides Private P.R.I.C.A.F./P.R.I.V.A.K.'s with the ability to create compartments or silos.

A Private P.R.I.C.A.F./P.R.I.V.A.K. is subject to C.I.T., but its tax base deviates from the normal C.I.T. regime and is limited to certain elements such as non-arm's length benefits received, nondeductible expenses, and payments in lieu of dividends in stock-lending transactions. Private P.R.I.C.A.F./P.R.I.V.A.K.'s do not pay other income taxes.

The Law of March 26, 2018, granted private investors in a Private P.R.I.C.A.F./P.R.I.V.A.K. a tax reduction of 25% of capital losses realized on the shares of a Private P.R.I.C.A.F./P.R.I.V.A.K. established after January 1, 2018. The loss will be equal to the excess of (i) the capital invested by the private investors over (ii) the sum of the distributions made by the Private P.R.I.C.AF./P.R.I.V.A.K. to the private investors as a result of the company's complete liquidation, plus the dividends paid to the private investors. The tax reduction is capped at €25,000 without indexation.

Dividends distributed by a Private P.R.I.C.A.F./P.R.I.V.A.K. are in principle subject to a 30% W.H.T. Several exceptions exist:

- Distributions paid from capital gains realized on shares held by a Private P.R.I.C.A.F./P.R.I.V.A.K. are exempt from W.H.T. As of January 1, 2018, the general participation exemption for capital gains on shares applies only if a corporate taxpayer holds a stake of at least 10% in the capital of the underlying company or the underlying investment has an acquisition value of at least €2.5 million. This requirement, as well as the one-year holding requirement, do not apply to participations held by an investment company, such as a Private P.R.I.C.A.F./P.R.I.V.A.K.

- Share redemptions and liquidation gains are also exempt from W.H.T.

- The Law of March 26, 2018, extended the application of a reduced dividend W.H.T. rate of 15% or 20% (the V.V.P.R. *bis* regime) to indirect investments, such as those held through a Private P.R.I.C.A.F./P.R.I.V.A.K.

A case that was brought before the Court of First Instance of Walloon Brabant involved a corporation that initially intended to carry out activities for its subsidiaries, but mainly due to lack of personnel, did not effectively do so.[107] In 2024, the Court ruled that this corporation was not entitled to deduct input V.A.T.

G. State Aid Investigation[108] - Belgian Excess Profit Rulings

In principle, taxation of Belgian companies is based on the total amount of book profits recorded on the company's books, including certain "disallowed expenses" as well as any distributed profits in the form of dividends.

However, the Belgian "Excess Profit Rulings" ("E.P.R.") regime allowed for special treatment of selected companies that were part of a multinational group.[109] This was based on the premise that the Belgian subsidiary or branch of the multinational group made a profit that could not be made by a hypothetical standalone company. Rather, the excess profit results from being part of a multinational group that brings along benefits such as synergies, economies of

---

107 Court of First instance of Walloon Brabant, February 5, 2024, 21/1583/A, available at www.monkey.be.

108 For further details about State Aid, *see* Chapter V, A.

109 Former Article 185, ¶2, b) I.T.C.

scale, reputation, and client and supplier networks. This excess profit was deductible from the Belgian entity's tax base, subject to the issuance of a favorable advance tax ruling by the Belgian Ruling Committee.

Between 2005 and 2014, Belgium applied the E.P.R. regime to approximately 55 entities. Most of them were allowed to claim a 50% to 90% deduction, without any indication that the deducted amounts were being included in a tax base elsewhere.

Surprisingly, Belgium neither notified the Commission of these rulings nor waited for the Commission's green light under the so-called "standstill obligation" before putting into effect the E.P.R. regime.

Nonetheless, due to the intensive publicity campaign under the catch phrase "Only in Belgium," the regime eventually drew the Commission's attention, triggering a preliminary investigation in December 2013 and a formal in-depth investigation in February 2015.

In January 2016, the Commission reached an adverse decision, concluding that the E.P.R. regime constituted an aid scheme within the meaning of Article 1(d) of Council Regulation (E.U.) 2015/1589. The Commission was of the view that by discounting excess profit from a beneficiary's tax base, Belgian Revenue Service selectively misapplied the I.T.C. and endorsed unilateral downward adjustments of the beneficiaries' tax base although the legal conditions were not fulfilled.

The Commission also argued that the Belgian practice of issuing E.P.R.'s in favor of certain companies may have discriminated against certain other Belgian companies, which did not or could not receive a ruling. The Commission found that Belgian E.P.R.'s gave a selective advantage to specific multinational companies, allowing them to pay substantially less than the regular amount of Belgian C.I.T. they would owe without an E.P.R. being in place.

The Commission issued a recovery order under which Belgium was required to take all necessary measures to recover the purported aid from all beneficiaries during the relevant ten-year period. The total amount to be recovered exceeded €900 million.

Following the Commission's negative decision and recovery order, Belgium and Magnetrol International, one of the beneficiaries of purported aid, lodged an action before the General Court of the European Union ("E.G.C.").

In February 2019, the E.G.C. annulled the Commission's decision. The court found that the Commission failed to establish the existence of an aid scheme but did not conclude on whether the E.P.R.'s gave rise to unlawful State Aid.

In April 2019, the Commission lodged an appeal to the E.C.J. to seek clarity on the standards for establishing a State Aid scheme.

In September 2019, the Commission also announced the opening of separate in-depth investigation procedures in which E.P.R.'s are labeled as individual aid.

In December 2020, Advocate General ("A.G.") Kokott issued a favorable opinion regarding the appeal lodged by the Commission against the E.G.C.'s judgment of 14 February 2019. According to the A.G., the Commission rightfully earmarked the Belgian practice of making downward adjustments to profits of Belgian corporate taxpayers forming part of a multinational group as an unlawful State Aid scheme. The opinion recommended that the E.C.J. set aside the judgment of the E.G.C. and refer the case back to the E.G.C. for a second review.[110]

In September 2021, the E.C.J. followed the A.G.'s opinion and overruled the E.G.C.'s Ruling. The E.C.J. ruled that the three

---

110 For further details, see W. Heyvaert and V. Sheikh Mohammad, "Turning Point in the Belgian Excess Profit Rulings Appeal Procedure - Advocate General Kokott Backs the European Commission's Aid-Scheme Theory," *AKD Newsflash*, December 18, 2020 (available at https://www.akd.eu/insights/turning-point-in-the-belgian-excess-profit-rulings-appeal-procedure).

conditions for an aid scheme to exist were met. However, the E.C.J. only looked into the methodological aspects of the E.G.C.'s judgment and referred the case back to the E.G.C., which was instructed to decide on open questions such as the existence of a selective advantage and the identification of the beneficiaries of the alleged aid.

On September 20, 2023, the E.G.C. ruled that Belgium's E.P.R. regime constitutes unlawful State Aid. In so doing, the E.G.C. confirmed the Commission's 2016 decision and rejected all arguments put forward by the Belgian state. According to the E.G.C., the Commission rightly found that the E.P.R. regime constituted financing through state resources by not taxing the excess profit, which in principle did form part of taxable profits in Belgium, resulting in a loss of tax revenue belonging to the state.[111] The E.G.C. also confirmed that the application of a downward profit adjustment "requires a correlation between the profit adjusted downwards in Belgium and profit included in another group company established in another State."[112] Because the E.P.R.'s are unilaterally issued, they are not part of the reference system (meaning the ordinary or "normal" tax system applicable).[113]

The E.G.C. also found that the E.P.R. regime conferred a selective economic advantage on the beneficiary as it led to a relief from tax that would otherwise have been due under the Belgian corporate tax rules that distinguishes between economic operators in a comparable factual and legal situation.[114] In addition, the Court confirmed that the E.P.R. regime was selective because (i) it could only be used by entities that were part of a multinational group of

---

111 E.G.C., September 20, 2023, Case T-131/16 RENV, available online on CURIA - Documents (europa.eu), paragraphs 26-32 (the "E.G.C. Ruling").

112 *Id.*, see paragraph 74 of the E.G.C. Ruling.

113 Article 185, §1, ¶2 I.T.C.; see also paragraphs 114-117 of the E.G.C. Ruling.

114 See paragraphs 107-113 of the E.G.C. Ruling.

companies,[115] (ii) it could not be used by companies that had decided not to make investments, centralize activities, and create jobs in Belgium,[116] and (iii) it could not be taken advantage of by companies belonging to a "small group."[117]

H. B.E.P.S. and F.A.T.C.A.

i. In General

In reaction to the O.E.C.D. initiative to combat base erosion and profit shifting (the "B.E.P.S. Project"), Belgium has implemented the following actions:

- Action Item 5 regarding the adoption of the I.I.D. using the modified nexus approach
- Action Item 2 regarding hybrid mismatches
- Action Item 3 regarding C.F.C. rules
- Action Item 4 regarding the interest limitation rule
- Action Items 8 through 10 and 13 regarding transfer pricing

Most measures were implemented in Belgium by December 31, 2018.

In 2021, the O.E.C.D. achieved a significant milestone by reaching an agreement on international tax reform to address B.E.P.S. One of the key measures included in this agreement focused on establishing a minimum tax rate of 15% for major multinational corporations,

---

115 Article 198, §1,10°/4 I.T.C.; see also paragraphs 119-124 of the E.G.C. Ruling.

116 See paragraphs 125-132 of the E.G.C. Ruling.

117 See paragraphs 133-140 of the E.G.C. Ruling: indeed, the Commission's "sample" had shown that "none of those rulings concerned entities belonging to small groups of undertakings."

known as the "Pillar Two" initiative. Building upon this global framework, the E.U. took action by publishing European Council Directive (E.U.) 2022/2523 on December 14, 2022. This directive closely aligns with the regulations outlined by the O.E.C.D. E.U. Member States were expected to implement this directive by December 31, 2023, at the latest.

Belgium met this expectation by implementing the Act of December 19, 2023, introducing a minimum tax for multinational companies and large domestic groups (published in the Belgian Official Gazette on December 28, 2023).

ii. B.E.P.S. Action 2: Hybrid Mismatches

The Belgian government implemented the E.U. anti-hybrid mismatch rule provided for in the A.T.A.D.[118] Dividends derived from a subsidiary are excluded from the D.R.D. to the extent that the subsidiary deducted, or could deduct, the dividend from its profit.

a. Definitions

Definitions of hybrid mismatch, hybrid entity, and hybrid transfer were introduced into Belgian tax law:[119]

- A hybrid mismatch is an arrangement resulting in either of two tax benefits. The first is a deduction of expenses for both a Belgian company or permanent establishment and a foreign enterprise or establishment thereof resulting in a double deduction. The second is a deduction for one of the participants to the arrangement without an income inclusion by the other participant resulting in a deduction without inclusion in income.

- A hybrid mismatch requires associated enterprises that are part of the same group or that act under a structured arrangement. No hybrid mismatch exists where the non-

118 Articles 185, 198, and 203 I.T.C.

119 See Article 2, ¶1, 16° I.T.C.

inclusion is due to the application of a tax regime that derogates from the standard tax law or differences in the value attributed to a payment, including differences resulting from the application of transfer pricing rules.

- A hybrid entity is any entity or arrangement that is regarded as a taxable entity under the laws of one jurisdiction but is treated as a transparent entity under the tax laws of another jurisdiction.

A "hybrid transfer" is any arrangement to transfer a financial instrument that is treated for tax purposes as having been derived simultaneously by more than one of the parties to the arrangement.

b. Taxable Hybrids

1) Disregarded Permanent Establishment Mismatch Rule[120]

Belgian companies will be taxed on profits attributable to a permanent establishment in another E.U. Member State that was exempt in that Member State under a tax treaty. Note that the profits must be realized due to a hybrid mismatch arrangement and not taxed in the jurisdiction where the permanent establishment is located.

2) Reverse Hybrid Entity Mismatch Rule[121]

Belgium will consider a hybrid entity incorporated or established in Belgium to be taxable if one or more associated nonresident entities are established in one or more jurisdictions that consider the Belgian entity to be taxable.

The hybrid entity's income will be taxed in Belgium to the extent that it is not already taxed under the laws of Belgium or any other

---

[120] Article 185, §1, ¶2 I.T.C.

[121] Article 185, §1, ¶3 I.T.C.

jurisdiction. This rule does not apply to collective investment vehicles.

3) Financial Instrument Mismatch[122]

A taxable hybrid mismatch may occur due to different characterizations of the same financial instrument or item of income resulting in a deduction for the foreign enterprise or its establishment and no inclusion for the Belgian company or establishment of the deemed beneficiary under the laws of the other jurisdiction.

4) Hybrid Entity Mismatch[123]

A hybrid mismatch exists where deductible income is paid by a foreign hybrid entity or its establishment in another country without a taxable inclusion for the Belgian company. This is the case when a foreign hybrid entity is considered transparent for Belgian purposes and as a taxable entity in the foreign jurisdiction.

c. Nondeductible Hybrids

The deduction of expenses in Belgium in the context of hybrid mismatches will be disallowed.

1) Double Deduction Rule[124]

Payments will be disallowed if there is a double deduction, for both a Belgian company or permanent establishment and a foreign enterprise or permanent establishment, from non-dual inclusion income.

---

122 Article 185, §2/1, a) I.T.C.

123 Article 185, §2/1, b) I.T.C.

124 Article 198, §1,10°/1 I.T.C.

2) Deduction Without Inclusion Rules[125]

The deduction of hybrid mismatch payments is prohibited in six instances where a payment is deductible in Belgium without a corresponding foreign inclusion:

- **Financial instrument mismatches**. A payment is made under a financial instrument where (i) the deduction without inclusion would be due to a difference in characterization of the instrument or income and (ii) the payment is not included in the taxable income of the beneficiary within a reasonable period of time.

- **Reverse hybrid entity mismatches**. A payment is made to a reverse hybrid entity, *i.e.*, an entity that is considered a taxpayer under Belgian law and as a transparent entity under the laws of another jurisdiction.

- **Hybrid allocation mismatches**. A payment is made to an entity with one or more establishments, where the non-inclusion abroad is the result of differences in the allocation of payments made to the hybrid entity's head office and its establishment, or between two or more establishments of that same entity.

- **Hybrid permanent establishment mismatches**. A payment is made to an entity that is regarded as a permanent establishment under the laws of its head office but disregarded under the law of the establishment's jurisdiction and the corresponding income is not taxable under the laws of the head office's jurisdiction.

- **Hybrid entity mismatches**. A payment is claimed as a deduction without being included in the beneficiary's taxable income, such as if a Belgian entity is treated as taxable in Belgium but as transparent in the recipient's jurisdiction.

---

125 Article 198, §1,10°/2 I.T.C.

- **Deemed permanent establishment payment mismatches**. A deemed payment is made between a head office and its permanent establishment, or between two or more permanent establishments, that has already been deducted from non-dual inclusion income.

3) Imported Hybrid Mismatches[126]

Imported hybrid mismatches occur between interested parties in foreign jurisdictions who shift the tax consequences to Belgium. For example, a Belgian entity contracts an ordinary loan with a foreign entity that itself has concluded a hybrid loan with another foreign entity.

4) Tax Residency Mismatch Rule[127]

Payments are not deductible if they are made by a Belgian domestic company that is also a tax resident in one or more other jurisdictions, and they are deductible from income in one of the other jurisdictions against income that is not taxable in that other jurisdiction. A deduction is allowed, however, if the other jurisdiction is an E.U. Member State with which Belgium has concluded a tax treaty that determines the company is treated as a Belgian-resident taxpayer.

Most of the above rules are applicable from 2020 (book years ending December 31, 2019).

iii. B.E.P.S. Action 3: C.F.C. Rules

Until January 1, 2019, Belgium did not have C.F.C. legislation in place *per se*, but it had, and still has, extensive anti-abuse rules with an effect similar to C.F.C. rules. For example, Article 344 §2 of the I.T.C. tackles transfers of assets to entities that are resident in tax havens. Article 54 of the I.T.C. denies the deduction of interest payments to low-taxed entities and Article 307 of the I.T.C. imposes

---

126 Article 198, §1,10°/3 I.T.C.

127 Article 198, §1,10°/4 I.T.C.

a reporting obligation on taxpayers making payments to offshore entities.

Belgian law contains a look-through tax, sometimes referred to as "Cayman tax" for income derived by individual taxpayers from the use of foreign vehicles such as trusts or foundations. Beginning in 2014, these juridical arrangements must be reported on the individual's personal income tax return, and in many instances, the trust or foundation will be considered tax transparent so that the income will be taxable directly in the hands of the resident individual who is the beneficiary.

In addition, the A.T.A.D. contains a C.F.C. component, which is intended to deter profit shifting to low-tax or no-tax jurisdictions. These C.F.C. rules are mandatory in all E.U. Member States. The Commission aims to discourage income shifting by re-attribution of income from a passive, lightly taxed C.F.C. to its E.U. parent company.

Belgium has opted to implement C.F.C. rules that target income only when derived by a C.F.C. through non-genuine arrangements set up for the essential purpose of obtaining a tax advantage.[128] These rules became effective as of January 1, 2019.

On December 22, 2023,[129] the Belgian C.F.C rules were reformed drastically. This reform shifts the Belgian C.F.C. regime from A.T.A.D. Model B (the transactional approach) to A.T.A.D. Model A (the entity approach). This means that the passive income of a C.F.C. that is directly owned by a Belgian controlling company (see the participation requirement below) and that is subject to low taxation abroad (see the taxation requirement below) will be added to the Belgian tax base of the controlling company, unless the C.F.C. can demonstrate sufficient economic substance.

The participation requirement is met if the taxpayer alone, or together with its associated entities, holds a qualifying participation

128 Article 185/2, ¶1 I.T.C.

129 Program Law, published in Belgian Official Gazette on December 29, 2023.

in a foreign company. The participation threshold is more than 50% of the voting rights in the foreign company, or at least a 50% participation in its capital or profit entitlement.

The Revenue Service published an explanatory note for corporate income tax returns for tax year 2024, followed by an Administrative Guidance on December 13, 2024,[130] with the following guidance:

- The taxpayer needs to hold (directly) at least one share[131] in the potential C.F.C.

- A purely indirect holding or a holding only through associated entities does not constitute a C.F.C.

- If the taxpayer holds at least one share, the direct participation of the taxpayer must be aggregated with the direct participation held by any associated entity (not on a *pro rata* basis) to assess if any of the participation thresholds are met by the taxpayer.

For example: Belgian Company A has a direct participation of 10% in foreign Company B and 40% in Company C. In turn, Company C has a direct participation of 42% in B. Since A and C are associated entities, the full participation for application of the C.F.C. regime is 52%.[132]

This implies that the notion of control under the new Belgian C.F.C. legislation (and A.T.A.D.) differs from its definition under the B.C.C.A. Taxpayers need to ensure that they pay proper attention to these differences when reviewing group entities that potentially

---

130 Admin. Guidance. No. 2024/C/82, of December 13, 2024.

131 Meaning a voting right, participation in capital, or profit entitlement right.

132 This is calculated as follows: 10% + 42% = 52%. In other words, there is no proportional calculation of the associate's participation, as this would result in a full participation for application of the C.F.C. regime calculated as 10% + (42% × 40%) = 26.80%.

qualify as C.F.C.'s, as they may lead to group entities that are not controlled by their parent companies under the B.C.C.A. unexpectedly qualifying as C.F.C.'s for tax purposes.

Additionally, the non-proportional computation may result in a corporation being a C.F.C. on behalf of several Belgian corporations. Suppose in our example that a fourth company ("D") holds 10% in B and 30% in C. In this case, D is also deemed to "control" B, since D also holds 52% in B (10% directly, and 42% indirectly through C). To determine which part of the undistributed profits of the C.F.C. is taxable in each Belgian corporation, only the direct participation (meaning for both A and D, only the 10%) is taken into account.

The taxation requirement is met when the C.F.C. is deemed to be low taxed, *i.e.,* if (i) it is not subject to any income tax or (ii) is subject to income tax at a rate that is less than 50% of the rate that would be imposed were it a resident of Belgium.[133] The C.F.C. will be presumed to be low taxed when it is established in a jurisdiction listed as a tax haven by the E.U. or Belgium (see above), although this presumption is rebuttable.

If the C.F.C. is not subject to income tax, the taxation requirement is automatically met. Whether the C.F.C. is subject to income tax is assessed on a case-by-case basis and by taking into account the list of income taxes from the P.S.D.[134] However, this list is not exhaustive.

Temporary differences may arise between the foreign tax paid and the theoretical Belgian tax owed when the foreign tax is initially lower or higher but is then subsequently offset by a corresponding increase or decrease in tax in later periods. To verify whether the foreign tax is at least half of the theoretical Belgian corporate income tax, adjustments can be made to account for these temporary differences, provided they relate to a period of no more than five years. Exceptions apply for depreciation of tangible fixed assets and

---

133 *Id.,* ¶2.

134 Part B of Annex 1.

for provisions of insurance companies, where longer correction periods are permitted.

The Belgian C.F.C. regime targets all undistributed passive profits of C.F.C.'s, provided these profits were realized during a taxable period of the C.F.C. that ends within the taxable period of the Belgian corporation. In straightforward cases where the C.F.C. and the Belgian corporation both use the calendar year as their accounting period, there is no mismatch, and the periods align seamlessly. However, if the C.F.C.'s accounting period differs, the undistributed passive profits realized during that period are included in the Belgian corporation's taxable base for the assessment year corresponding to the Belgian corporation's financial year in which the C.F.C.'s period ends. For example, if the C.F.C.'s accounting period runs from July 1, 2023, to June 30, 2024, the profits would be taxed in the Belgian corporation's assessment year 2025 (*i.e.*, for the financial year ending on or after December 31, 2024). The C.F.C.'s accounts determine which profits have been paid out as dividends. Any dividend distributed during the taxable period is deemed to stem from the profits realized in that same period. If the distributed dividend exceeds the profit realized in that period, the C.F.C. rules do not apply to the excess. Profit is considered distributed in the period in which it is realized, even if the dividend is only formally approved (and paid) in the following year.

A further question concerns how the taxation requirement should be applied when the C.F.C. is part of a tax consolidation or participates in a foreign group contribution regime. The Belgian Revenue Service accepts the following:

- In case of tax consolidation, the C.F.C. may apply an apportionment formula to allocate the consolidated tax burden to the C.F.C. for the purposes of the calculation.

- If the C.F.C. is involved in a group contribution regime, only the substantive Belgian conditions for deducting the group contribution are relevant; the formal requirements do not need to be met.

- From a pragmatic perspective, the Belgian Revenue Service accepts computations as if the C.F.C. operated on a "standalone" basis. This means that the theoretical Belgian C.I.T. is computed as if the C.F.C. were not part of a tax group and did not benefit from group contribution deductions.

- The C.F.C. can also propose an alternative computation method, which is evaluated by the Belgian Revenue Service on a case-by-case basis.

A C.F.C. with carried-forward tax losses must verify whether those carried-forward losses meet the requirements of Article 206 I.T.C. when computing the theoretical Belgian tax. The Belgian Revenue Service accept that carried-forward losses existing at the end of the taxable period related to assessment year 2023 (*i.e.,* financial years ending before December 31, 2023) are deemed to meet these requirements. Therefore, no historical reassessment is required for these carried-forward losses. The C.F.C. must only substantiate that carried-forward losses from assessment year 2024 onwards meet the statutory requirements.

A P.E. of a foreign company in which a Belgian company participates can be treated as a C.F.C. When assessing C.F.C. rules, the participation requirement is assessed at the foreign company level (which is deemed to own 100% of its P.E.). For the taxation requirement, both the tax paid by the P.E. and any additional tax paid by the C.F.C. on the P.E.'s profits must be considered. This prevents double taxation if profits are already taxed at the C.F.C. level. When evaluating whether the C.F.C. meets the taxation threshold, profits and taxes of P.E.'s not exempt by treaty must be included in the computation. The new C.F.C. legislation introduces three safe harbors at the level of the Belgian controlling company. The C.F.C. income inclusion should not be applied under the following circumstances:

- The Belgian controlling company shows that the C.F.C. carries out a substantial economic activity supported by personnel, equipment, assets, and buildings defined as "the offering of goods or services on a particular market," excluding intercompany services, unless the respective transactions are carried out at arm's length. The Belgian Revenue Service recognizes that a holding company can demonstrate genuine economic activity if it actively participates in the management of the group, for example, by having board representation or providing management services. Whether a holding company has sufficient staff, equipment, assets, and premises should be assessed based on the nature of its activities. Even if not all legal criteria (personnel, equipment, assets, premises) are met, the holding company can still corroborate that it performs a substantial economic activity.

- Less than one third of the total income of the C.F.C. originates from so-called "passive income."

- The C.F.C. is a regulated financial institution to which the E.B.I.T.D.A. interest deduction limitation does not apply, and for which one third or less of the total income is derived from transactions with the Belgian controlling company or entities associated with the latter.

To determine the portion of the C.F.C.'s income that must be included in the taxable basis of the Belgian controlling company, the profit of the C.F.C. must be based on Belgian accounting and tax rules as if the C.F.C. were located in Belgium. For corporations established within the E.E.A., the Belgian Revenue Service allows the use of the accounting result under the local G.A.A.P. of the relevant E.E.A. jurisdiction. In contrast, for corporations located outside the E.E.A., a full conversion of the accounting result to Belgian G.A.A.P. is required. The Belgian Revenue Service does not accept financial statements prepared in accordance with widely recognized standards such as I.F.R.S. or U.S. G.A.A.P. for this purpose.

The income to be included is then limited to (i) the part of income that is not distributed and (ii) the C.F.C.'s passive income. Passive income is broadly defined and includes, not only income from interest, royalties, dividends, and from the disposal of shares, but also income from rental and leasing property, certain financial activities, and income from the purchase and sale of goods and services which add little or no economic value to the C.F.C. This income is allocated in proportion to the Belgian company's direct voting rights, direct ownership rights in the share capital, or rights to the profits of the C.F.C. (whichever is higher).

iv. B.E.P.S. Action 4: Excessive Interest Deductions

Similar to most other countries, Belgium already had various rules limiting excessive interest deductions. The most well-known rule is the 5:1 thin capitalization rule, under which interest payments or attributions in excess of a 5:1 debt-equity ratio are not tax deductible. In addition, Belgium implemented the A.T.A.D. by providing an interest limitation rule to discourage companies from creating artificial debt arrangements designed to minimize tax. This rule entered into effect on January 1, 2019, and first became effective for tax assessment year 2020. Interest is deductible only up to a certain amount, *viz*., the greater of 30% of an entity's tax-adjusted earnings before interest, taxes, depreciation, and amortization (essentially E.B.I.T.D.A.) or €3 million. This was accomplished by enactment of the Law of December 25, 2017, which transposed A.T.A.D. into national law.[135]

Loans entered into prior to June 17, 2016, are grandfathered. Consequently, interest on such loans will not be subject to the limitation based on 30% of E.B.I.T.D.A., provided that no substantial changes are made to these loans on or after June 17, 2016. According to the Minister of Finance, substantial changes are, *inter alia*, changes in the duration of the loan, the interest rate due under the loan, or a party to the loan. Additionally, financial institutions are carved out of the interest limitation rule altogether.[136]

---

[135] Article 40 of the Law of December 25, 2017, on the C.I.T. Reform (*Belgian State Gazette,* December 29, 2017) introducing Article 198/1 I.T.C., to take effect on January 1, 2020.

[136] For further information on the interest limitation rule, see W. Heyvaert and E. Moonen "Belgium – ATAD Implementation in Belgium: An Analysis of the New Interest Limitation Rule," *European Taxation*, 2019, Vol. 59, No. 7 pp. 354-360.

For purposes of the interest limitation rule, certain items are earmarked as equivalent to interest and, thus, captured by the rule. A Royal Decree dated December 27, 2019, provides a description of income and expenses that are economically equivalent to interest. Included are payments under profit participating loans, capitalized interest, foreign exchange gains/losses related to interest payments, guarantee provisions, and original issue discount on interest-free or abnormally low-interest loans. Taxpayers seeking certainty can request a ruling as to specific costs and products.

v. **B.E.P.S. Actions 8, 9, 10, and 13: Transfer Pricing**

Belgium has transfer pricing rules in place to avoid profit shifting, and in recent years transfer pricing audits have increased significantly. However, until recently, there were no specific statutory transfer pricing documentation requirements under Belgian law. It is of course advisable to have sufficient documentation available, as a lack of documentation may result in a thorough transfer pricing audit.

Belgium has enacted legislation to introduce specific transfer pricing documentation requirements based on B.E.P.S. Action 13. This means that the O.E.C.D.'s recommended three-tiered approach to transfer pricing documentation is mandatory in Belgium. As a result, a Belgian entity forming part of an international group that meets certain thresholds based on its standalone financial statements[137] must compile a Master File and a Local File if certain criteria are met. In addition, if the ultimate parent of a multinational group is a Belgian company, and if it has gross consolidated revenue of at least €750 million, it must file a Country-by-Country Report with the Belgian Revenue Service within 12 months from the closing of the consolidated financial statements of the group.

On July 15, 2024, three new royal decrees were published in the Belgian Official Gazette concerning the forms for the Local File (275 LF), the Master File (275 MF), and the Country-by-Country

---

[137] These thresholds are (i) a sum of operating and financial income of €50 million, (ii) a balance sheet total of €1 billion, or (iii) an annual average of 100 employees.

Report notification (275 CBCNOT).[138] These new forms, together with their explanatory notes, introduce significant additional documentation requirements for fiscal years beginning on or after January 1, 2025. The new royal decrees replace those of October 28, 2016.

The Local File consists of three parts: (i) general information about the Belgian group entity by business unit, (ii) a detailed form for mainly financial information (which is only mandatory if there have been more than €1 million in cross-border intragroup transactions), and (iii) an optional section for providing further details and documentation.

The most important change in the new Local File form appears in Table B10, which covers the transfer pricing methodology and studies by business unit and by type of transaction. The reporting entity is now required to attach all information from this table (the transfer pricing methodology, framework agreement, model contract, and transfer pricing study) to the Local File as a readable PDF, provided this documentation is available. Previously, submitting such documents was optional. Additionally, both the detailed financial statement of related party transactions and the section on cost contribution agreements, advance pricing agreements, advance decisions, and in-house (re)insurances must now include the country code for each business unit. Finally, the tax identification numbers of foreign P.E.'s and major competitors must also be included.

---

[138] R.D. of June 16, 2024, replacing the R.D. of October 28, 2016, establishing the model form referred to in Article 321/2, § 5 I.T.C., published in Belgian Official Gazette on July 15, 2024; R.D. replacing the R.D. of October 28, 2016, establishing the model form referred to in Article 321/4, § 4 I.T.C., published in Belgian Official Gazette on July 15, 2024; R.D. replacing the R.D. of October 28, 2016, establishing the model form referred to in Article 321/5, § 4 I.T.C., which allows for the filing of the local file in transfer pricing matters, published in Belgian Official Gazette on July 15, 2024.

The Master File now requires additional information, such as a detailed value chain analysis, a functional analysis, and extensive information on intangible assets and financial transactions. The Belgian requirements go beyond the O.E.C.D. guidelines.

The Country-by-Country Report notification form has also been modified. The Belgian entity must now indicate whether the notification is an initial filing, an amendment, or a termination. Annual notification is no longer required. Such notification is only required in the event of changes to the previous notification.[139]

The Belgian Government Agreement indicated that the transfer pricing documentation obligations – particularly for S.M.E.'s – would be simplified and restricted to essential requirements. However, at present, the draft legislation does not introduce any changes to the existing transfer pricing documentation obligations.

vi. <u>F.A.T.C.A.</u>

F.A.T.C.A.'s primary function is to require financial institutions outside the U.S. to report information on U.S. account holders to the I.R.S. The associated penalty for noncompliance is the "big stick" of a 30% U.S. W.H.T. on certain income and principal payments to recalcitrant financial institutions. The W.H.T. applies to payments made by all persons, even those unrelated to the U.S. account in issue.

On April 23, 2014, Belgium concluded a Model 1 Reciprocal Agreement with the U.S., meaning that foreign financial institutions established in Belgium will be required to report information on U.S. account holders directly to the Belgian Revenue Service, who in turn will report to the I.R.S.

On April 24, 2025, the Belgian Data Protection Authority ("D.P.A.") issued a ruling regarding the collection and transmission of personal data under F.A.T.C.A. According to the D.P.A., the current practices – specifically, the systematic collection and transfer of data

---

[139] Article 321/3 I.T.C.

concerning individuals to U.S. – are in breach of Belgian data protection laws.

The D.P.A. found that the processing of personal data for F.A.T.C.A. purposes lacks sufficient legal basis under the E.U.'s General Data Protection Regulation ("G.D.P.R.") and Belgian privacy legislation. As a result, the D.P.A. concluded that the current F.A.T.C.A. data collection and transmission practices violate Belgian data protection rules. The ruling may have significant implications for financial institutions and the Belgian government, potentially requiring changes to how F.A.T.C.A. is implemented in Belgium to ensure compliance with data protection requirements.

vii. Pillar Two - Minimum Tax for Multinational Companies and Large Domestic Groups

The Law of December 19, 2023, introducing a minimum tax for multinational companies and large domestic groups states that based on the consolidated figures of the group, taxpayers need to identify the jurisdictions in which the effective tax burden is lower than 15%. The 15% minimum tax rate is then achieved through three different surcharges:

- **Qualified Domestic Top-up Tax ("Q.D.M.T.T."):** This tax applies if all Belgian entities in the aggregate do not pay tax at an effective rate of 15%, for example, due to the application of tax incentives such as the investment deduction or the I.I.D.

- **Income Inclusion Rule ("I.I.R."):** If foreign group entities are taxed in one or more low-tax jurisdiction, the Belgian ultimate parent entity or a Belgian intermediate parent entity will be partly taxed on that income proportional to the parent entity's ownership interest in the qualifying income of the low-taxed group entity. If the low-tax jurisdictions impose an income top-up tax, Belgium can only apply the I.I.R. if the exchange of information shows that the low-taxed jurisdictions have not (sufficiently) taxed the income.

- **Undertaxed Profit Rule ("U.T.P.R."):** If the Revenue Service in the country of a targeted parent entity does not fully apply the I.I.R., the Revenue Service in the other countries where the group operates can disallow tax deductions or impose withholding taxes to arrive at a minimum 15% overall corporate tax rate. Belgium has opted to levy an additional U.T.P.R. tax.

The minimum tax provided for in the Law of December 19, 2023, took effect from 2024 (for fiscal years beginning on December 31, 2023, or later), except for the U.T.P.R. surcharge, for which a grace period applies until 2025.

The computation of the various surcharges goes as follows:

- The minimum tax legislation applies to large multinational groups with consolidated sales exceeding €750 million during two out of the four previous fiscal years and to domestic groups exceeding the €750 million threshold. Group entities can be either corporations or permanent establishments. Certain entities are excluded (*e.g.*, government agencies, international organizations, non-profit organizations, pension funds, investment funds, and real estate investment vehicles).

- The result for each jurisdiction is then determined based on the consolidated financial statements of the group for the local group entities, with certain adjustments (*e.g.,* exemptions for dividends and capital gains, certain disallowed expenses, and transfer pricing adjustments). The result is the qualifying income or loss by jurisdiction.

- Subsequently, the effective tax levied on the local group entities in each jurisdiction is computed. Deferred taxes are also taken into account.

- The difference between the effective tax rate and the minimum tax rate (15%) results in the percentage of the top-up tax, which is then multiplied by the excess profit of the jurisdiction. Excess profit is determined by reducing the qualifying income of the jurisdiction by an exclusion based on substance (the substance based income exclusion, or

"S.B.I.E.").[140] If applicable, the domestic top-up tax payable abroad must be considered (see above). If a loss is recorded in a particular jurisdiction, no top-up tax is applied. There is a *de minimis* exclusion if all group entities in a jurisdiction generate revenue of less than €10 million on average and a profit of less than €1 million on average for the reporting year and the two preceding years.

- Finally, it is determined which group entities in Belgium are liable for the Q.D.M.T.T., the I.I.R. surcharge, or the U.T.P.R. surcharge.

To reduce the administrative burden for both multinational groups and Revenue Service, "safe harbors" have been developed to easily determine whether there is no risk of low-taxed profit in a particular jurisdiction. Pending the final list of safe harbors, a temporary arrangement has been developed based on the data in the group's country-by-country report.[141]

To determine that a jurisdiction poses no risk of low-taxed profit, three tests have been devised:

- ***De Minimis* Test:** The group has reported total revenues of less than €10 million and a profit (loss) before income tax of less than €1 million in that jurisdiction in its country-by-country report.

- **Effective Tax Rate ("E.T.R.") Test**: The (i) relevant taxes in the financial reporting and (ii) the profit (loss) before income tax from the country-by-country report demonstrate that the effective tax rate exceeds 15% for reporting years starting in 2023 or 2024, 16% for reporting years starting in 2025, and 17% for reporting years starting after 2026.

---

140 Specifically excluding a standard return on tangible assets amounting to 10% in 2023 (decreasing to 5% in 2033) and payroll costs amounting to 8% in 2023 (decreasing to 5% in 2033).

141 Article. 321/1, 15° I.T.C.

- **Routine Profit Test**: The group's profit (loss) before income tax in a jurisdiction does not exceed the amount of income excluded based on concepts of economic substance, calculated by using the abovementioned percentages of tangible assets and payroll costs.

The Minister of Finance has confirmed that a carried-forward D.R.D. is included in the "relevant taxes" that count towards achieving the effective tax rate of 15%. Deferred taxes related to a carried-forward D.R.D. are treated the same as losses carried forward for the calculation of the minimum tax. Therefore, the use of a carried-forward D.R.D. does not negatively impact the calculation of the minimum tax, as it does not risk falling below the 15% threshold and thus does not necessitate a top-up tax. The application of the minimum tax at the level of a foreign subsidiary results in a tax burden of 15%, thus satisfying the taxation requirement of the D.R.D.[142] The minister noted that the D.R.D. does not apply if low-taxed income accumulated in years before the introduction of the minimum tax are distributed. This means that dividends from countries with a local top-up tax of at least 15% are generally eligible for the D.R.D., unless another exclusion applies.

Meanwhile, measures have already been introduced to safeguard the I.I.D. from the effects of the minimum tax legislation (see above). Additionally, the O.E.C.D. has introduced further "safe harbors" concerning the Q.D.M.T.T. and the U.T.P.R. Finally, there is a simplified calculation for non-substantial entities that are not included in the consolidated financial statements of the group due to their limited size or materiality, based on the data in the group's country-by-country report.[143]

Multinational groups within the scope of the minimum tax must apply for an enterprise number with the Crossroads Bank for Enterprises. This requirement applies not only to Belgian groups but also to foreign groups. The enterprise number is necessary to use the online MyMinfin applications and to validly make any advanced payments on the minimum tax. If such advance payments are not

---

[142] Article 203 § 1, 1, 1° and 203 § 1, 2 I.T.C.

[143] See art. 321/1, 15° I.T.C.

made during the financial year, the amount of any minimum tax due will be increased.

In principle, groups only need to file an information form in one country. However, because it may take some time for the necessary data to reach the Belgian Revenue Service, a form must be submitted that only includes the I.I.R. and the U.T.P.R. due in Belgium. Based on this form, the Belgian Revenue Service can impose tax.

On May 21, 2024, the Belgian Revenue Service issued further guidance regarding the Pillar Two notification requirement. For Pillar Two reporting periods commencing between January 1, 2024, and June 13, 2024, a specific notification form was required to be submitted by July 13, 2024. For groups whose first Pillar Two reporting period begins after June 13, 2024, the notification must be filed within 30 days of the start of the first Pillar Two reporting year.

On July 2, 2024, the Revenue Service announced an extension of the notification deadline to September 16, 2024, for groups that did not intend to make advance payments. The original deadlines remained unchanged for multinational enterprise groups and large domestic groups that intended to make advance payments.

On April 10, 2025, a draft tax form was published that companies subject to the Q.D.M.T.T. could use, which aligned with the Global Information Return ("G.I.R.") template. Groups must be registered in Belgium to submit the Q.D.M.T.T. form, with the first filing deadline set for November 30, 2025. According to the accompanying press release, further instructions on completing the form will be provided in due course.

viii. Income Tax Treaties

As of June 12, 2024, Belgium has 95 income tax treaties in effect, with the jurisdictions listed below.[144]

---

[144] Belgium has negotiated or is negotiating new treaties with several other countries.

Albania	Finland	Macedonia	Singapore
Algeria	France	Malaysia	Slovakia
Argentina	Gabon	Malta	Slovenia
Armenia	Georgia	Mauritius	South Africa
Australia	Germany	Mexico	South Korea
Austria	Ghana	Moldova	Spain
Azerbaijan	Greece	Mongolia	Sri Lanka
Bahrain	Hong Kong	Montenegro	Sweden
Bangladesh	Hungary	Morocco	Switzerland
Belarus	Iceland	Netherlands	Taiwan
Bosnia & Herzegovina	India	New Zealand	Tajikistan
Brazil	Indonesia	Nigeria	Thailand
Bulgaria	Ireland	Norway	Tunisia
Canada	Israel	Pakistan	Turkey
Chile	Italy	Philippines	Turkmenistan
China	Ivory Coast	Poland	Ukraine
Congo (Dem. Rep.)	Japan	Portugal	U.A.E.
Croatia	Kazakhstan	Romania	U.K.
Cyprus	Kosovo	Russia	U.S.A.
Czech Republic	Kuwait	Rwanda	Uruguay
Denmark	Kyrgyzstan	San Marino	Uzbekistan
Ecuador	Latvia	Senegal	Venezuela
Egypt	Lithuania	Serbia	Vietnam
Estonia	Luxembourg	Seychelles	

In addition, Belgium has in effect a substantial number of Tax Information and Exchange Agreements ("T.I.E.A.'s"). Nearly all of these T.I.E.A.'s are concluded with countries that do not have a comprehensive income tax treaty in force with Belgium, *i.e.*, most often tax havens.

Belgium signed the Multilateral Instrument to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("M.L.I."), thereby incorporating the minimum standards outlined by the B.E.P.S. Project into its existing tax treaties. Belgium designated 95 of its income tax treaties as Covered Tax Agreements, i.e. tax treaties to be modified through the M.L.I.[145]

On October 1, 2019, the M.L.I. entered into force for Belgium. For an income tax treaty to be covered by the M.L.I., both signatories must have (i) joined the M.L.I., (ii) included each other in their list of covered income tax treaties, and (iii) deposited their instruments of ratification.

Belgium submitted reservations against the agency permanent establishment provision. Regarding the elimination of double taxation provided for in the M.L.I., Belgium will incorporate Option B regarding the credit method in its existing double tax treaties so long as the other contracting state is also a party to the M.L.I. and has not stated any reservations regarding this provision.

Recent significant changes include the signature of replacement income tax treaties with France on November 9, 2021,[146] and the Netherlands on June 21, 2023.[147] Other changes include the signature of a competent authority agreement with Austria on May 30, 2023, the signature of an agreement relating to the interpretation of Article 5 of the income tax treaty with the Netherlands on November 23, 2023, regarding employees working from a home office, and the signature of a mutual agreement regarding Part VI (arbitration) of the M.L.I. with Switzerland on July 3, 2023.

---

145 See the official website of the Belgian Ministry of Finance for the full list of countries: MyMinfin (fgov.be).

146 See P.-J. Wouters, "The Belgium-France Income and Capital Tax Treaty (2021): What's New?" *Bulletin for International Taxation*, 2022, Vol. 76, No 3, pp. 159-167.

147 See W. Heyvaert, "New bilateral tax treaty Belgium and the Netherlands," November 7, 2023. (available at https://www.akd.eu/insights/new-bilateral-tax-treaty-belgium-and-the-netherlands).

I. <u>D.A.C.6 – Mandatory Disclosure of Aggressive Cross Border Tax Structures</u>[148]

On May 25, 2018, the Council of the European Union adopted Directive (E.U.) 2018/855 (referred to as "D.A.C. 6"). This Directive introduced mandatory disclosure rules for E.U.-linked intermediaries or, under specific circumstances, for taxpayers themselves (*e.g.,* when the intermediary is precluded from reporting by virtue of the client-attorney privilege).

Belgium implemented the Directive into domestic law on December 12, 2019 (*Belgian State Gazette,* December 30, 2019). Under Belgian law, cross-border arrangements are reportable if they meet at least one of the hallmarks set out in the Law (which are identical to hallmarks A-E listed in Annex IV of the Directive). Hallmarks are broad categories setting out particular characteristics identified as potentially indicative of aggressive tax planning. Most hallmarks enter into play only if they meet a so-called "main benefit test" (*i.e.,* where a tax benefit is the main or one of the main objectives of the arrangement). Belgian law does not cover purely domestic arrangements.

Until recently, the reporting deadlines were (a) August 31, 2020, for arrangements with a first step implemented between June 25, 2018, and July 1, 2020, and (b) within 30 days for arrangements with a first step implemented effective July 1, 2020, or later. However, due to the COVID-19 crisis, Belgium extended these deadlines.

The Law of December 20, 2019, provided that fines for any failure to report in a timely, sufficient, and complete manner would range from €1,250 to €100,000. On May 10, 2023, the Supreme Administrative Court (*Raad Van State* or *Conseil d'État*) annulled the Royal Decree implementing administrative fines and provided

---

148 See W. Heyvaert and V. Sheikh Mohammad, "European Union's New Reporting Obligations for Tax Intermediaries: Key Features of the Belgian Administrative Guidance – D.A.C.6," *Insights*, Vol. 8, No 2 (2021), pp. 3-10 (available at https://publications.ruchelaw.com/news/2021-03/Belgium.pdf).

guidance in the application of such fines. This does not mean that administrative fines can no longer be imposed. The minimum and maximum penalty rates are still regulated by the Law of December 20, 2019.

An intermediary who is precluded from reporting pursuant to a legal professional privilege ("L.P.P.") must inform in writing any other intermediary or the relevant taxpayer of the fact that the reporting obligation shifts to them. However, the L.P.P. exemption does not apply for the reporting of marketable arrangements. The question arose whether the Belgian Constitutional Court would accept this restrictive interpretation of the L.P.P.[149] Several Belgian bar and attorney associations introduced annulment procedures before the Belgian Constitutional Court to request the annulment of the Law.

Noting that the notification obligation was required to satisfy the requirements of the Directive, the Belgian Constitutional Court requested a preliminary ruling from the E.C.J.[150] The request for a preliminary ruling concerned the compatibility of the Directive with Article 7 (right to respect for private life) and Article 47 (right to a fair trial) of the Charter of Fundamental Rights of the E.U. insofar as it requires legal counsel to notify other intermediaries of a need to report under D.A.C. 6.

On December 8, 2022, the E.C.J. confirmed in *Orde van Vlaamse Balies and Others v. Vlaamse Regering* (Case C-694/20) that the obligation for lawyer intermediaries advising on potentially aggressive cross-border tax arrangements to notify other nonclient intermediaries of their reporting obligations *vis-à-vis* the Revenue Service infringes on the right of taxpayers to have the privacy of

---

149 See W. Heyvaert and V. Sheikh Mohammad, "*Secret professionnel de l'avocat et D.A.C. 6 - une conciliation (im)possible ?*" *Journal de droit fiscal*, 2019, No 11, pp. 321-329; L. Vanheeswijck, "*D.A.C. 6: het einde van het beroepsgeheim in fiscale zaken?*" *Tijdschrift voor fiscaal recht*, 2019, n° 560, p. 377.

150 E.C.J., *Orde van Vlaamse Balies and Others v. Vlaamse Regering*, Case C-694/20, December 21, 2021, available at www.curia.europa.eu.

their communications with legal counsel respected. With this landmark judgment, the E.C.J. confirmed that the L.P.P. protects the confidentiality of lawyer-client communications not only in relation to the exercise of the client's rights of defense, but also for legal advice beyond the context of litigation. On July 20, 2023, the Belgian Constitutional Court annulled the Flemish regulations transposing D.A.C. 6 in this regard (Case No. 111/2022) and similar cases are now pending before the Belgian Constitutional Court for the other transposing measures.[151]

On July 29, 2024,[152] the E.C.J. further clarified the scope of the L.P.P. in the context of D.A.C.6 by holding that only attorneys-at-law and, in very limited cases, other professionals who are authorized to represent clients in legal proceedings, can invoke the L.P.P. to be exempt from the reporting obligation under D.A.C.6. The C.J.E.U. rejected a broader interpretation that would allow other intermediaries, such as accountants or tax advisors, to rely on professional secrecy to avoid the reporting requirement. As a result, only attorney-intermediaries are relieved from both the reporting and notification obligations when the L.P.P. applies, while other intermediaries remain subject to the full scope of D.A.C.6 reporting duties. This strict interpretation was adopted to preserve the effectiveness of D.A.C.6 and to avoid inconsistencies across E.U. Member States. The Belgian Constitutional Court previously took a broader view, but the C.J.E.U.'s ruling now requires a narrower application of the L.P.P., potentially prompting further legislative amendments to ensure compliance with E.U. law.

---

151 The Belgian Constitutional Court issued an interlocutory judgment on the Federal transposing measures (Case No. 103/2022). There are cases pending regarding the Walloon transposing decree (joint case numbers 7480, 7498 and 7537), the transposing decree of the French-speaking community (case numbers 7535, 7581, and 7585) and the transposing ordinance of the Brussels-Capital Region (case numbers 7481, 7510, 7511, and 7521).

152 E.C.J., Case C-623/22, July 29, 2024, available at www.curia.europa.eu.

At the time of writing, Belgium had not taken any legislative action to transpose the E.C.J. ruling of July 29, 2024, into national law.

J. A.T.A.D. 3 – Unshell Directive

One of the latest tax developments in the E.U. is the proposal for a Council Directive laying down rules to prevent misuse of shell entities for tax purposes. Introduced by the European Commission in December 2021, the Directive is commonly referred to as A.T.A.D. 3 or the "Unshell Directive."

In the Explanatory Memorandum of the draft proposal, the Commission explains the purpose of the Directive:

> While important progress has been made [in the area of ensuring fair and effective taxation] in the last years, especially with the adoption of the Anti-Tax Avoidance Directive (A.T.A.D.) and the expansion of scope of the Directive on Administrative Cooperation (D.A.C.), legal entities with no minimal substance and economic activity continue to pose a risk of being used for improper tax purposes, such as tax evasion and avoidance, as confirmed by recent massive media revelations.

In fact, within the E.U., legal personality is granted by Member States based on purely formal requirements such as minimum capital or minimum number of shareholders, without any review of or checks on the economic activity of the entity.

Therefore, it is relatively easy for non-E.U. investors to interpose an E.U. entity to enjoy advantageous tax treatment under D.T.T.'s, E.U. primary law such as the fundamental freedoms or secondary law such as the P.S.D. and the I.R.D., and national laws of Member States.

To combat the inappropriate use of shell companies, the draft proposal outlines rules to identify shell entities in the E.U., to allow for the exchange of information among Member States about identified shell entities, and to deny E.U. tax benefits to identified

#40761577v1

shell entities. Purportedly, the goal is not to make shell entities disappear, but to avoid their abusive use for tax purposes.

If adopted and implemented, undertakings deemed as lacking minimal substance would be denied treaty benefits and benefits under E.U. primary and secondary law, particularly under the P.S.D. and I.R.D.

i. First Step: Is the Entity in Scope?

All E.U. entities are in scope except entities with listed securities, such as publicly traded stocks or bonds and regulated entities. In the initial proposal by the Commission, entities with at least five full-time employees are also out of scope. However, this exclusion was removed by the European Parliament.

In contrast with the O.E.C.D.'s Pillar One and Pillar Two initiatives, the A.T.A.D. 3/Unshell Directive is not limited to large M.N.E.'s.

ii. Second Step: Is the Entity at Risk?

The proposed Directive describes elements that identify undertakings that may lack substance and are at risk of potential misuse for tax purposes. It initially specifies the criteria that would lead to the obligation for taxpayers to report their substance on their tax returns. To be "at risk," an entity must meet three criteria:

- More than 65% of its income or assets are categorized as passive.
- More than 55% of its activities or assets relate to cross-border transactions.
- Administration and management are outsourced to a third-party.

If an entity is at risk, it must report the following on its annual tax return:

- Whether premises are available for its exclusive use (shared use by entities of the same group also counts).

- Whether it has at least one active E.U. bank account.

- Whether at least one qualified director or the majority of the full-time employees live close to the undertaking and are involved in the decision-making process.

The current proposal suggests that Member States impose a penalty of at least 2% of the entity's turnover for incorrect reporting or failure to report. In the event of a false declaration, an additional penalty of at least 4% of the entity's revenue would be imposed.

National revenue services must assess each year whether an entity or undertaking is a shell based on the information furnished by the company. A presumed shell entity can present proof to show it has genuine economic activity and sufficient nexus with the Member State of which it claims to be a tax resident. Even if an entity is not a shell under the A.T.A.D. 3/Unshell Directive, it may still be considered a shell under national law.

iii. Third Step: What if the Entity is a Shell?

Shell entities are not eligible for tax benefits under the network of D.T.T.'s in force and effect of the Member State in which tax residence is claimed. Also, it is not considered to be resident in that Member State for purposes of claiming benefits of certain European Directives, such as the P.S.D. and the I.R.D.

The Unshell Directive is currently being discussed behind closed doors in the Commission's working groups. In fact, as per the report on tax issues during the Belgian presidency of the European Council, a possible way forward was presented during a meeting of the Working Party on Tax Questions which took place on June 11, 2024.[153] In December 2024, the Council reported that some Member States emphasized the need for clarity regarding the alignment of

---

153 "Draft Ecofin Report to the European Council on Tax Issues - Approval." Council of the European Union, June 14, 2024. Available at https://data.consilium.europa.eu/doc/document/ST-10594-2024-INIT/en/pdf.

the Unshell Directive with the D.A.C. They also called for a simple, straightforward framework to minimize administrative burdens for both Revenue Service and businesses.

Currently the status of the Unshell Directive is blocked.[154] At the time of writing, the Unshell Directive may indeed be incorporated into a revamped version of D.A.C. 6.

154 Pereira, Lídia. "Unshell - Laying down Rules to Prevent the Misuse of Shell Entities for Tax Purposes | Legislative Train Schedule." Legislative Train Schedule, May 21, 2025. Available at https://www.europarl.europa.eu/legislative-train/package-business-taxation/file-unshell-directive.