2018 Annual Tax Seminar

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Arendt House, 29 November 2018

Welcome and introduction

Thierry Lesage, Partner

Anti-tax avoidance directive (ATAD): 5 measures to remember

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Recent VAT developments about Holdings and other VAT novelties

Bruno Gasparotto, Partner

Taxes in 2019 and beyond

Thierry Lesage, Partner

Welcome and introduction

ATAD: 5 measures to remember

1. Introduction: the measures under ATAD I and ATAD II

Controlled Foreign Company rule

- **ATAD I** : The Member State of a parent company will be allowed to tax certain non-distributed income of certain subsidiaries

Exit taxation

- **ATAD I** : Member States will apply an exit tax on assets moved out of their territory

Interest limitation

- **ATAD I** : There will be a limitation of the amount of net interest that a company can deduct from its taxable income, based on a fixed ratio of its earnings (EBITDA)

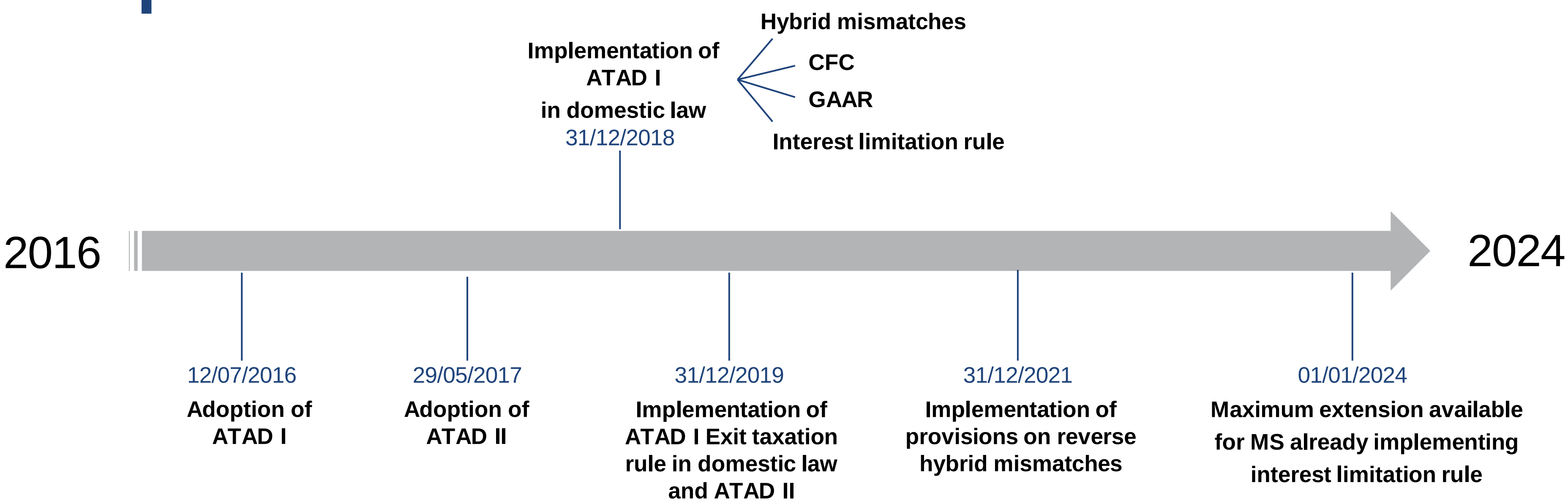
Hybrids

- **ATAD I** : neutralisation of hybrid mismatches between Member States resulting in a double deduction or a deduction without inclusion, by ensuring that a payment is subject to tax at least once
- **ATAD II** : Extension to third countries

General Anti-Abuse Rule

- **ATAD I** : It will allow tax authorities to disregard artificial tax arrangements and compute the tax liability in accordance with national law
- Point of attention: principal purpose test

2. ATAD I and ATAD II: timeline of implementation



From 01.01.2019	Application of ATAD I (except Exit taxation rule)
From 01.01.2020	Application of Exit taxation rule (under ATAD I); and Application of ATAD II (except reverse hybrid mismatches provision)
From 01.01.2022	Application of reverse hybrid mismatches provision (under ATAD II)

3. Luxembourg bill of law implementing ATAD I

- Bill of law No. 7318 (“**ATAD I Bill**”) approved by the Luxembourg government on 15 June 2018 and submitted to the Luxembourg parliament on 19 June 2018

- Comment of the Luxembourg State Council published on 13 November 2018

- ATAD I Bill expected to be adopted before year-end

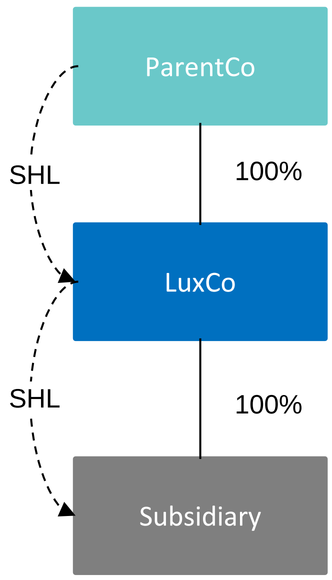
- Faithful transposition of ATAD I with the choice of the most favourable options and the use of the possible exclusions

4. Interest limitation rules

	Implementation in Luxembourg
Purpose	Prevent the excessive use of debt financing
Definition	▪ Net borrowing costs only deductible up to the higher of (i) 30% of the EBITDA or (ii) EUR 3 million ▪ Intragroup and third party debt within the scope
Derogation	Full deduction of exceeding borrowing costs if standalone entity (entity with no consolidated account and no associated enterprise outside Luxembourg)
Exclusions	▪ Loans issued before 17 June 2016 (to the extent no subsequent modification to the conditions of the loan) ▪ Loans used to fund long-term public infrastructure project under certain conditions (EU scope) ▪ Financial undertakings (*e.g.* credit institutions, AIFM, UCITS, AIF, securitisation vehicles as defined by Regulation (EU) 2017/2402 of 12 December 2017)
Carry forward (chosen option)	Unlimited carry-forward of disallowed borrowing costs and 5-years (max) carry-forward of unused interest capacity
Consolidated group (chosen option)	Equity ratio: net borrowing costs fully deductible if taxpayer ratio equity/total assets ≥ 98% of ratio equity/total assets of the group (provided the use of the same evaluation method)
Entry into force	FY starting on or after 1 January 2019

4.1. Interest limitation rules – Structures impacted

- Debt financing debt – equity financing equity



- LuxCo finances its **participation** in its subsidiary through **equity only**. The **SHL** granted to its subsidiary is financed through **SHL**
- **In, or out of scope?**

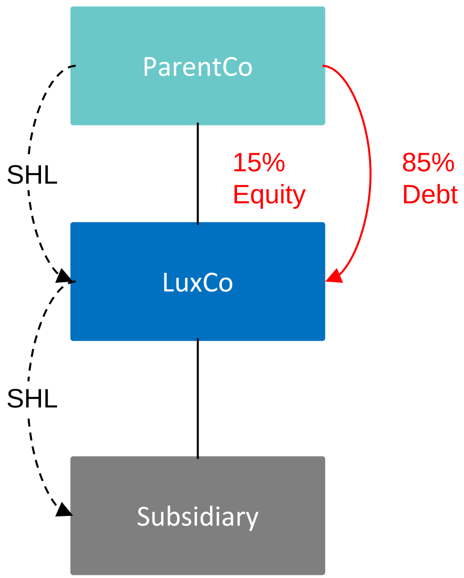
➢ LuxCo incurs **interest expenses corresponding to its interest income** (less its taxable remuneration)

➢ Thus, deductible **borrowing costs < taxable interest** revenue so that **no excess borrowing costs** should arise at the level of LuxCo

<u>Conclusion</u>: interest deduction limitation rule should not apply to LuxCo

4.2. Interest limitation rules – Structures impacted

- Debt financing debt & equity – Scenario 1



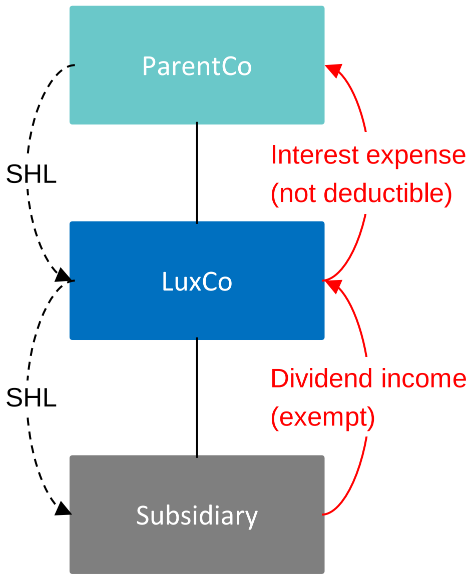
- Concerning the <u>back-to-back financing activity</u>, LuxCo incurs **interest expenses corresponding to its interest income** (less its taxable remuneration)

- LuxCo has interest expenses on the debt financing its <u>participation</u> in the subsidiary, thus deductible interest expenses **are exceeding** its interest income

<u>Conclusion</u>: interest deduction limitation rule should apply

4.3. Interest limitation rules – Structures impacted

- Debt financing debt & equity – Scenario 2



- Concerning the <u>back-to-back financing </u>activity, LuxCo incurs **interest expenses corresponding to its interest income** (less its taxable remuneration)
- LuxCo has interest expenses on the debt financing its <u>participation</u> in the subsidiary, thus deductible interest expenses **are exceeding** its interest income

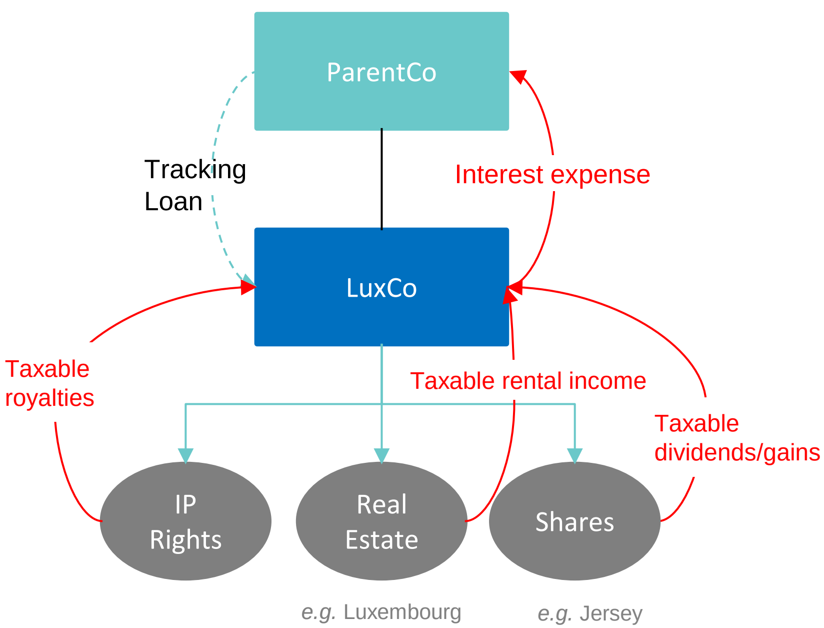
➢ Attention: to the extend that LuxCo receives exempt dividend/capital gain) from its participation, **any expenses** on the debt financing **are <u>not deductible</u>** (up to the amount of exempt income)

<u>Conclusion 2</u>: as the borrowing cost are **not deductible** (up to the amount of exempt dividends), they are not taken into account to calculate LuxCo's exceeding borrowing cost. Provided that in a given year, the interest **expense does not exceed exempt income**, deductible expenses are not higher than interest income → no exceeding borrowing costs

NO IMPACT

4.4. Interest limitation rules – Structures impacted

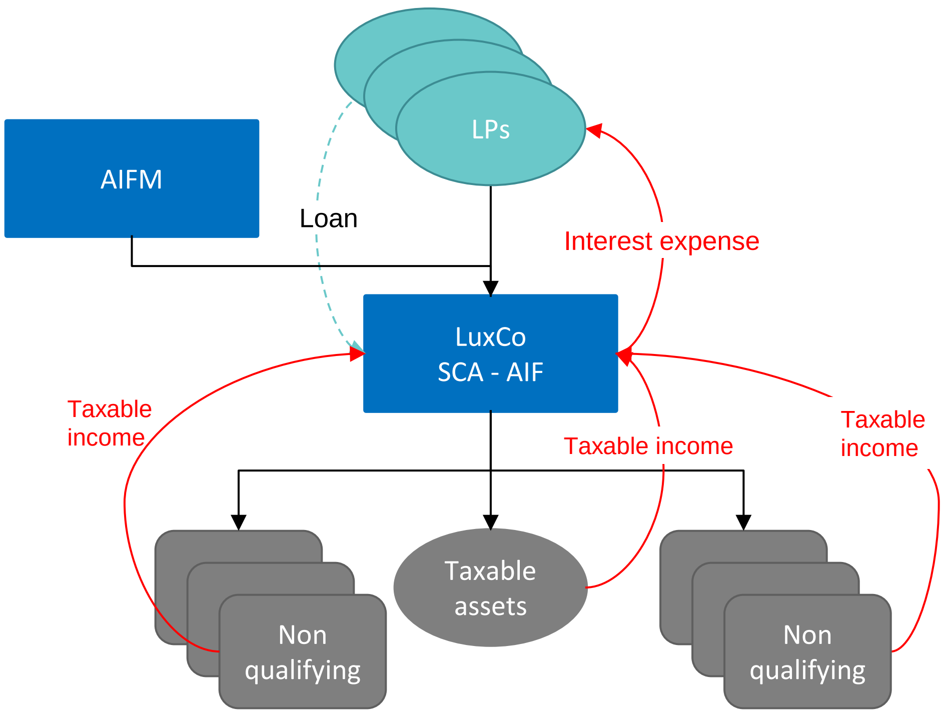
- Holding of taxable assets financed by debt



- LuxCo's **deductible interest expenses are higher** than its interest **income** → LuxCo has **exceeding borrowing costs**

4.5. Interest limitation rules – Structures impacted

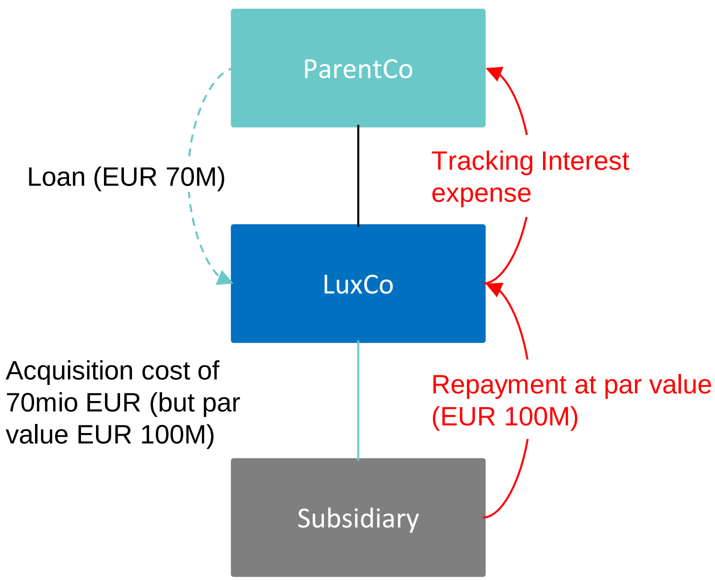
- Holding of taxable assets – Fund structure



- AIFs managed by AIFMs (and AIFMs themselves) are excluded from the scope of application of the interest limitation rule

4.6. Interest limitation rules – Structures impacted

- Distressed debt



- LuxCo buys distressed debt (valued below par value) and **receives interest** on such debt. LuxCo finances this acquisition through debt with interest rate **tracking the income** perceived on the distressed debt
- Debt (and interest thereon) is entirely **repaid** up to its **original value**, so that LuxCo realises a **gain of EUR 30 Million.** Interest payment made by LuxCo tracks the interest received on the distressed debt **plus the gain** realised thereon. Interest **expenses are higher** than its interest **income** → LuxCo has **exceeding borrowing costs**

Conclusion : interest deduction limitation rule might apply

5. Hybrid mismatch rules

	Implementation in Luxembourg
Purpose	▪ Eliminate double non-taxation in structured arrangement resulting from differences in the legal characterisation of hybrid entities and hybrid financial instruments.
Scope	▪ Intra-EU situations involving hybrid entities and hybrid financial instruments ▪ Hybrid mismatches with non-EU countries which are within the scope of ATAD II will be included in a separate bill of law (entry into force as from 1st January 2020 and 1st January 2020 for reverse hybrids)
Definition of an hybrid mismatch	▪ Differences in the legal characterisation of (i) a financial instrument or (ii) entity, in an arrangement structured (a) between a Luxembourg taxpayer and an associated enterprise in another MS or (b) when the commercial or financial relations between a Luxembourg taxpayer and an associated enterprise in another MS, give rise to a double deduction ("**DD**") or to a deduction without inclusion ("**D/NI**")
Associated enterprise	▪ In case of hybrid payment: 25% or more of voting rights or capital or entitlement to 25% or more of profits ▪ In case of hybrid entity: 50% or more of voting rights or capital or entitlement to 50% or more of profits
Tax consequences	▪ To the extent a hybrid mismatch results in a DD: the deduction shall be given only in the MS of the payer ▪ To the extent a hybrid mismatch results in a D/NI: the MS of the payer shall deny the deduction
Evidence	▪ Upon request of the Luxembourg tax authorities, the Luxembourg taxpayer has to be able to demonstrate the tax treatment in the other MS
Entry into force	FY starting on or after 1 January 2019

5.1. Hybrid mismatch rules – Structures impacted

- Example 1: Hybrid financial instrument mismatch

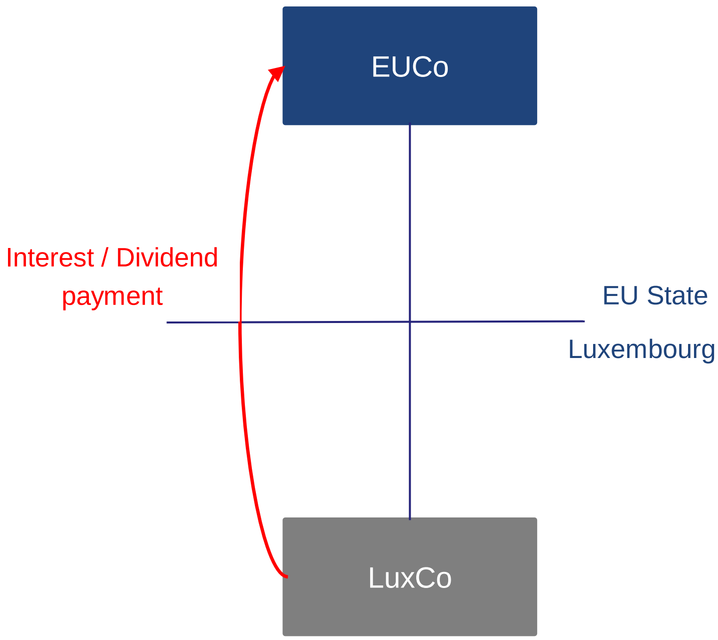
Facts:

- EUCo and LuxCo are associated enterprises
- EUCo lends money to LuxCo at market interest rate

- In Luxembourg: the loan is treated as a debt instrument and payments on the loan are thus treated as an interest deductible expense for LuxCo
- Under the laws of EUCo: the loan is treated as an equity instrument (i.e. a share) and payments on the loan are thus treated as a dividend exempt income for EUCo

Outcome: D/NI
Hybrid mismatch? Yes

ATAD implication:
- The deduction shall be denied at LuxCo level



5.2. Hybrid mismatch rules – Structures impacted

- Example 2: Hybrid entity mismatch

Facts:

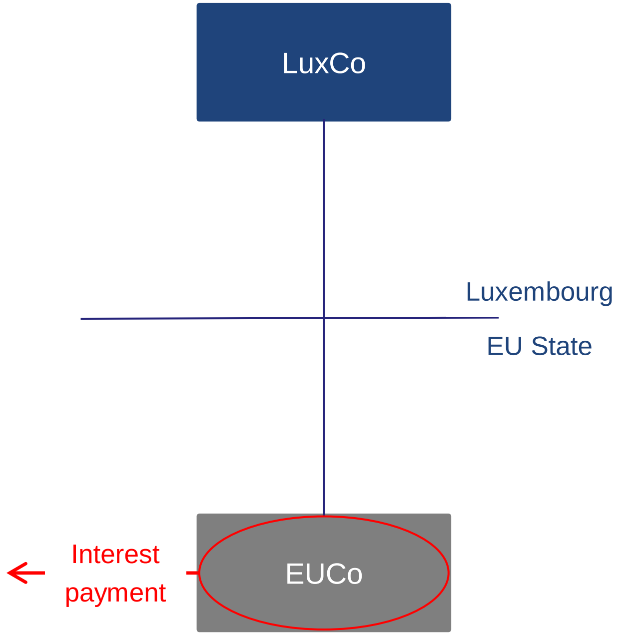
- EUCo and LuxCo are associated enterprises
- EUCo borrows money from a third party

- Under the laws of the other EU State: EUCo is treated as non-tax transparent, the loan is treated as a debt instrument and payments on the loan are thus treated as an interest deductible expense for EUCo
- In Luxembourg: EUCo is treated as tax transparent, the loan is treated as a debt instrument and payments on the loan are thus treated as an interest deductible expense for LuxCo

Outcome: D/D
Hybrid mismatch? Yes

ATAD implication:

- The deduction shall be denied at LuxCo level



5.3. Hybrid mismatch rules – Structures impacted

- Example 3: Interest payment to an exempt person?

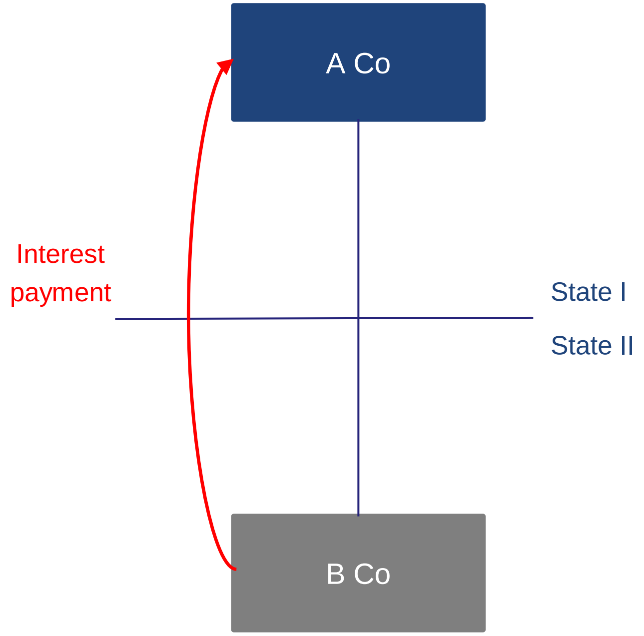
Facts:

- A Co is a fund and is exempt from tax on all income
- A Co and B Co are associated enterprises
- A Co lends money to B Co at market interest rate

- Under the laws of State II: the loan is treated as a debt instrument and payments on the loan are thus treated as an interest deductible expense for B Co
- Under the laws of State I: the loan is treated as a debt instrument but payments on the loan are not included in A Co due to its tax exempt nature

Outcome: D/NI

Hybrid mismatch? No as the mismatch is only attributable to A Co's status and not to the terms of the financial instrument



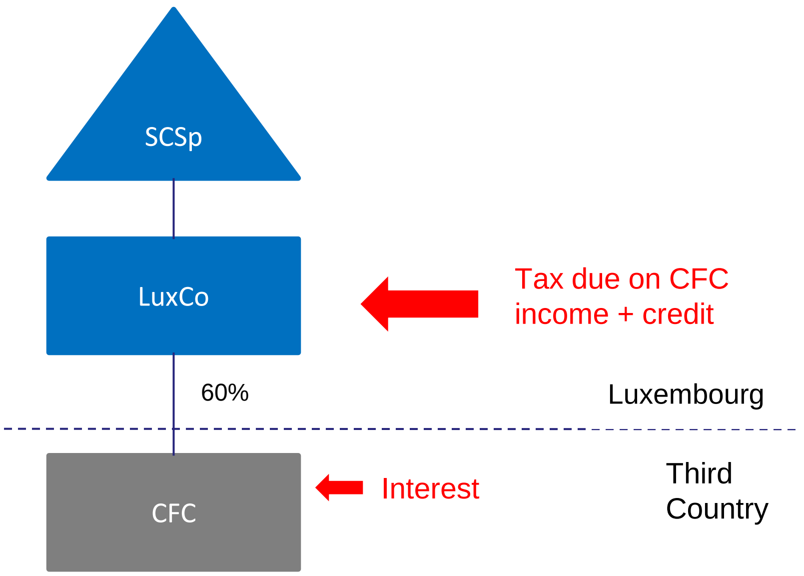
6. CFC rules

	Implementation in Luxembourg
Purpose	▪ Re-attribution of the undistributed income of the direct or indirect controlled foreign company ("**CFC**") to the Luxembourg taxpayer to the extent arising from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage
Application of the CFC rules	▪ The rules are applied if the cumulative criteria are fulfilled: ▪ **the level of participation** *i.e.* direct or indirect holding via related entities of more than 50% of voting rights <u>or</u> capital <u>or</u> entitlement to more than 50% of the profits of the entity. ▪ **the amount of tax paid by the CFC** *i.e.* whether the actual CIT paid by the entity / PE on its profits is lower than the difference between (i) the CIT that would have been charged in Luxembourg and (ii) the actual CIT paid by the entity / PE. ▪ **non-genuine arrangements** *i.e.* the entity / PE does not own the assets which generate its income nor would have undertaken the related risks if it were not controlled by the taxpayer in which the people and functions are carried out and are instrumental in generating the CFC income. ▪ **the purpose** i.e. the main purpose is to obtain a tax advantage.
Exemptions	▪ Entity or PE with accounting profits of no more than EUR 750,000 ▪ Entity or PE of which the accounting profits amount to no more than 10% of its operating costs for the relevant tax period
Inclusion of CFC income in the taxpayer's taxable base	▪ CFC income must be included for corporate income tax ("**CIT**") but not for municipal business tax ("**MBT**") purposes: ▪ <u>Only CFC income generated by the assets and risks</u> related to the functions carried out by the taxpayer which are instrumental in generating the CFC income (*i.e.* TP analysis required). ▪ If the total of the net CFC income is negative: no inclusion and carry-forward. In case of positive income at a later stage, possible offset with non-deducted carry-forward negative CFC income. ▪ CFC income is included in the taxable base of the taxpayer <u>prorata to the participation of the taxpayer</u> in the CFC .
Entry into force	FY starting on or after 1 January 2019

6.1. CFC rules – Structures impacted

- Direct holding – before distribution

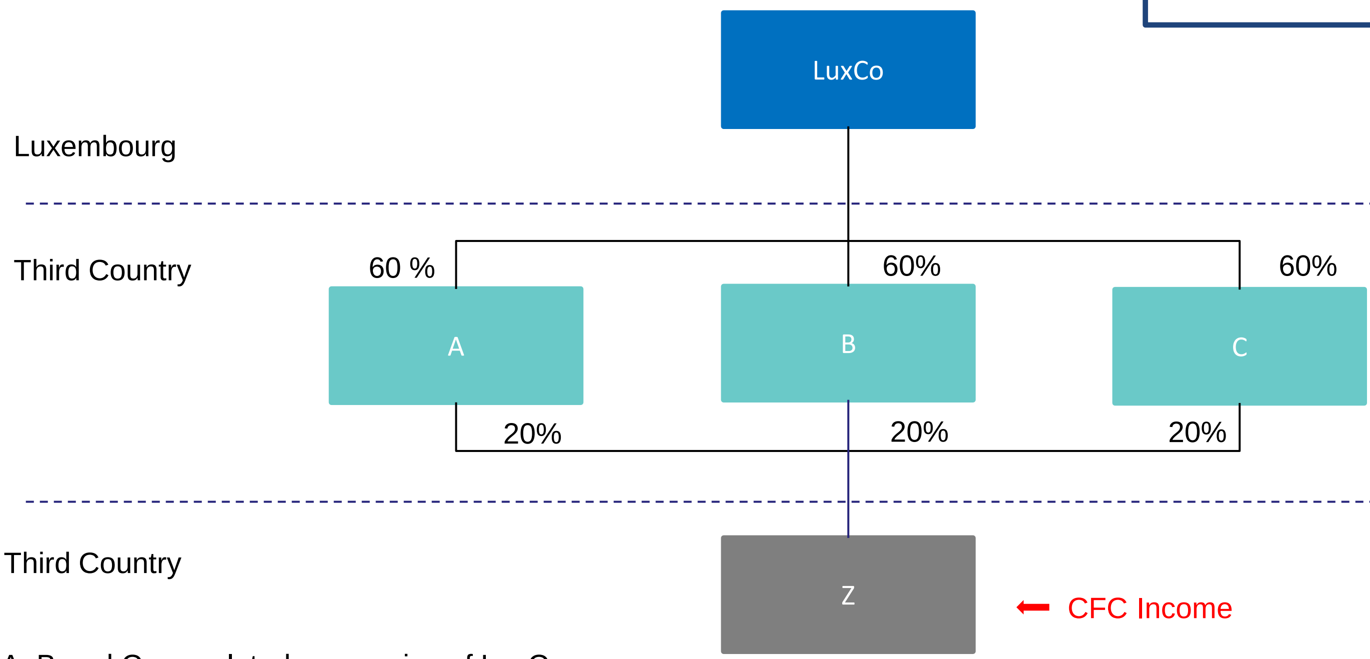
  - Type of income: interest
  - Taxation:
    - ✓ CFC Taxation: 5%
    - ✓ Lux CIT taxation on the same base: 19%
    - ✓ *i.e.* CFC Tax < 50% Lux CIT
  - Control: 60%
  - Substantive economic activity?
  - Thresholds?
  - Luxembourg taxation of CFC income in relation to activity performed by LuxCo and in proportion to the shareholding – 60%) – tax credit on foreign tax paid in CFC jurisdiction.



6.2. CFC rules – Structures impacted

- Indirect holding via related companies

> ➢ Related companies: 25% in voting rights or share capital



⇒ A, B and C are related companies of LuxCo
⇒ Z is considered as a CFC given that LuxCo indirectly controls 60% of Z
⇒ If non-genuine arrangement for tax purposes: CFC income (after TP analysis) is included in proportion to its participation in Z (*i.e.* 36%)

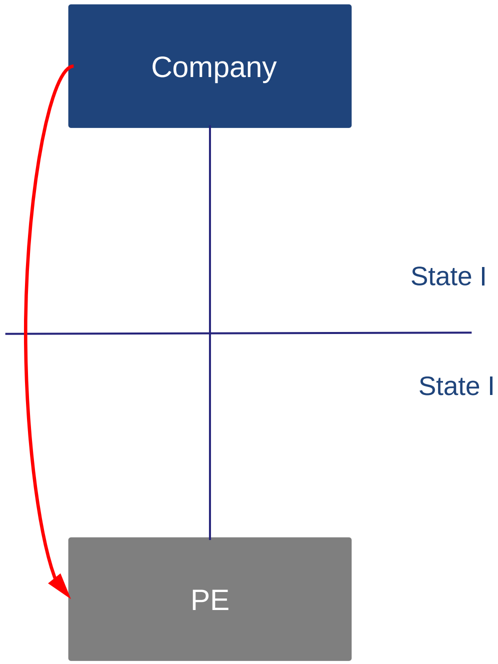
7. Exit taxation rules

	Implementation in Luxembourg
Purpose	▪ Alignment of the existing exit tax with the ATAD I provisions in case of certain cross-border transfer of assets i.e. no tax deferral but taxation at the time of the exit (with entitlement to payment in instalments over 5 years under conditions)
Migration and transfer of assets out of Luxembourg	▪ Transfer of assets from Luxembourg to a PE located in another State if Luxembourg does no longer have the right to tax the transferred assets; ▪ Transfer of assets from a Luxembourg PE to the head office or another PE located in another State if Luxembourg does no longer have the right to tax the transferred assets; ▪ Transfer of tax residence to another State (except for assets allocated to a Luxembourg PE with same accounting values) ▪ Transfer of business carried on through a PE to another State if Luxembourg does no longer have the right to tax the transferred business; ➡ Luxembourg taxpayer subject to tax at an amount equal to the market value of the transferred assets <u>at the time of the exit</u>, less their book value for tax purposes The exit tax will not be applicable in certain cases (e.g. assets pledged as collateral) or short term transfers.
Option for instalment	▪ Conditions: Transfer to a EU or EEA country which has concluded an agreement with Luxembourg or the EU on the mutual assistance for the recovery of tax claims ▪ Up to a maximum of 5 years
Migration and transfer of assets to Luxembourg	▪ Companies migrating to Luxembourg or transferring their assets to Luxembourg will benefit from a step-up
Entry into force	▪ Transfers occurring during FY starting on or after 1 January 2020 ▪ Existing transfers and transfers made prior to 1 January 2020 unaffected by the new provisions

7.1. Exit taxation rules

- 1st case (Art.1.3°a) ATAD I Bill :

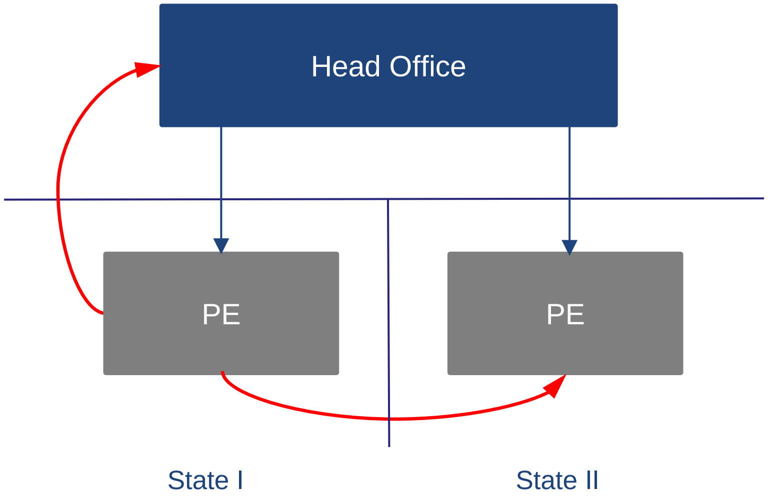
  - A taxpayer transfers assets from its head office to its PE in another MS or in a third country



Exit taxation rules

- 2nd case (Art.1.3°b) ATAD I Bill :

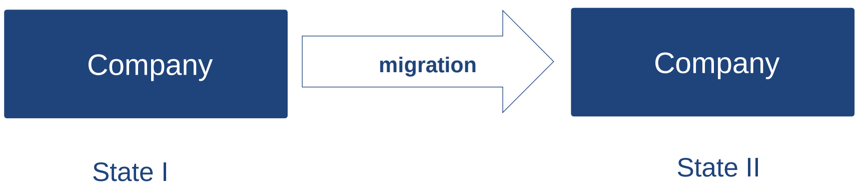
  - A taxpayer transfers assets from its PE in a MS to its head office or another PE in another MS



7.3. Exit taxation rules

- 3rd case (Art.1.3°c) ATAD I Bill :

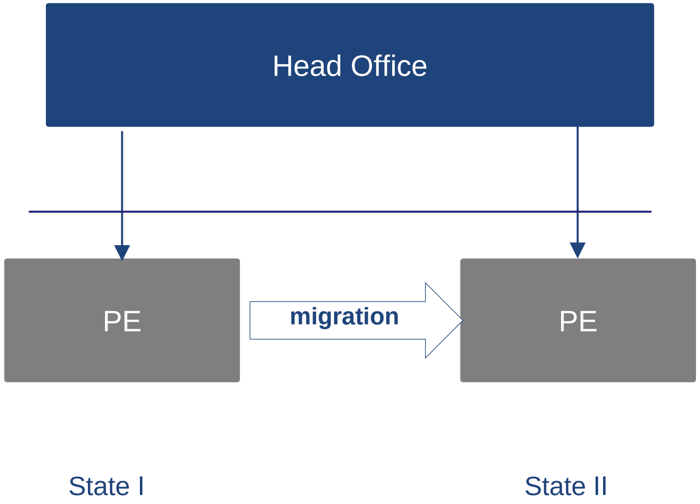
  - A taxpayer transfers its tax residence to another MS (except for those assets which remain effectively connected with a PE in the first MS)



7.4. Exit taxation rules

- 4th case (Art.1.3°b) ATAD I Bill :

  - A taxpayer transfers the business carried on by its PE from a MS to another MS



7.5. Exit taxation rules

- The exit tax will <u>not be applicable</u> to short term transfers:

- Asset transfers related to the financing of securities;
- Assets posted as collateral or where the asset transfer takes place in order to meet prudential capital requirements or;
- For the purpose of liquidity management provided that the assets are set to revert to the transferor within a period of 12 months (short term transfers).

7.6. Exit taxation rules

Current Regime

- The current regime provides under certain circumstances for an optional deferral of the payment of tax on the capital gains realised upon migration, without any time limit as long as the taxpayer is the owner of these assets and is a tax resident in a European Economic Area ("**EEA**") member state.
- Taxpayer may be entitiled to defer the payment without any time limit.
- Current tax regime available only for tranfers within the EU, EEA and a third country with an exchange-of-information clause under the DTT.

New regime

- No option of payment deferral of the tax on capital gains under ATAD Law Bill.
- But for EU transfers the taxpayer may be entitiled to defer the payment of the exit tax by instalments over a maximum of 5 years.
- Certain temporary transfers not exceeding 12 months are excluded.
- Deferral taxation only for EU and EEA (under certain circumstances) transfers.

8. GAAR

	Implementation in Luxembourg
Purpose	▪ Allowing the Luxembourg tax authorities to disregard artificial arrangements
Scope	▪ Application to direct taxes for corporate <u>as well as individual taxpayers</u> (broader scope than under ATAD I)
Definition of abuse of law	▪ *There is an abuse of law if the <u>legal route</u> which, having been used for the main purpose or one of the main purposes of <u>circumventing or reducing tax</u> contrary to the <u>object or purpose of the tax law</u>, is not <u>genuine</u> having regard to all relevant facts and circumstances.* ▪ *The legal route, which may comprise more than one step, shall be regarded as non-genuine to the extent that it was not used <u>for valid commercial reasons</u> which reflect economic reality.* ▪ The taxpayer is entitled to use the most favourable tax route.
Burden of proof unchanged	▪ Luxembourg tax authorities have to first prove that the constituting elements of an abuse of law are met. ▪ Then, the Luxembourg taxpayer has to provide sufficient valid commercial reasons that justify the transaction.
Taxation	▪ In case of an abuse, taxes are due by the taxpayer as if the chosen legal route was genuine. ▪ Tax already paid will be credited against the tax actually due and if such credit is not possible, the tax will be refunded
Entry into force	FY starting on or after 1 January 2019

9. Other measures in a nutshell

- **Exchange of assets arising from the conversion of convertible debt into shares (as from 1st January 2019)**

As from 1st January 2019, conversion of a convertible debt into shares will thus be considered as a sale of the convertible debt at FMV, followed by the acquisition of shares at FMV. The capital gain arising from this transaction may no longer be rolled-over into shares received in exchange but must be treated as realised and subject to tax at the time of the conversion.

- **Permanent establishment included in double tax treaty (as from 1st January 2019)**

The definition of permanent establishment is to be constructed solely on the basis of the criteria mentioned in an applicable double tax treaty. The Luxembourg tax authorities may also request from the taxpayer a confirmation from the other contracting State that the permanent establishment is effectively recognized in its territory.

Recent VAT developments about Holdings and other VAT novelties

Recent VAT developments about holding companies

- What are the main learnings from the ECJ about the VAT status of holding companies as per EU case law before 2018 ? Back to previous case law (**I**)

- Three major decisions rendered by the CJEU in 2018
  - Marle Participations case, CJEU C-320/17, 5 July 2018 (**II**)
  - Ryanair case, CJEU C-249/17, 17 October 2018 (**III**)
  - C&D Foods case, CJEU C-502/17, 8 November 2018 (**IV**)

1. Some previous key ECJ decisions applicable to holding companies

Some previous key ECJ decisions

i. A holding company whose sole purpose is to acquire holdings in other undertakings, without involving itself directly or indirectly in the management of those undertakings does not have the status of a taxable person for the purposes of VAT and does not have any input VAT deduction right (*CJEC, 20 June 1991, aff. C- 60/90, **Polysar** Investments Netherlands BV*),

ii. The <u>disposal</u> of shares is an output transaction exempt from VAT (*CJEC, 6 April 1995, aff. C- 4/94, **BLP** Group*).

Where a taxable person supplies services to another taxable person who uses them for an exempt transaction (i.e. disposals costs incurred before a sale of shares), the latter person is not entitled to deduct the input VAT paid, even if the ultimate purpose of the transaction is the carrying out of a taxable transaction (i.e. continue to carry out taxable activities).

Some previous key ECJ decisions

iii. The involvement of a holding company in the management of its subsidiaries constitutes an economic activity *(CJEC, 27 September 2001, aff. C- 16/00,* ***Cibo*** *Participations SA)*

- This corresponds to the situation where it carries out transactions which are subject to VAT, such as the supply of administrative, financial, commercial and technical services

- Expenditure incurred in connection with the <u>acquisition</u> of a shareholding in a subsidiary forms part of its general costs and therefore has, in principle, a direct and immediate link with its business as a whole.

- Thus, if the holding company carries out both transactions in respect of which VAT is deductible and transactions in respect of which it is not, it may deduct only that proportion of the VAT which is attributable to the former.

Some previous key ECJ decisions

iv. The <u>disposal</u> of the shares in a wholly-owned subsidiary in which it is involved by a holding company is, in principle, a economic activity. However, the disposal of <u>all</u> shares is equivalent to the "transfer of a totality of assets" and does not constitute an economic activity subject to VAT *(CJEC, 29 octobre 2009, aff. C- 29/08, **AB SKF**).*

A taxable person who has acquired supplies of services in order to carry out a disposal of shares in a subsidiary and in a controlled company, and with which those services have a direct and immediate link, does not have the right to deduct VAT on those services, even when the disposal of shares is a transaction which contributes to the objective of restructuring the taxable person's industrial activities.

v. Expenditure connected with the <u>acquisition</u> of subsidiaries which the holding company involves itself in their management must be regarded as belonging to its general expenditure and the VAT paid on that expenditure must, in principle, be deducted in full *(CJEU, 16 July 2015, aff. C-108/14 C-109/14, **Larentia + Minerva**).*

- If the involvement concerns only some of the acquired subsidiaries, the input VAT on the costs acquisition is partial and deductible on a prorata basis (in proportion of the involvement in the managed subsidiaries).

2. Marle Participations case, C-320/17, 5 July 2018

Marle Participations case, C-320/17, 5 July 2018

1) Background of the case

- Marle Participations ("Marle") is the holding company of the Marle group. In addition to its shareholding activities, Marle also rents out buildings to group subsidiaries. In the context of a group restructuring, Marle was involved in acquisitions and sales of shares in subsidiaries. Marle applied a full input VAT deduction right on expenses relating to this restructuring which was later rejected by the French tax authorities.

2) Question referred for a preliminary ruling

- Does the **letting of a building** by a holding company to a subsidiary constitute **direct or indirect involvement** in the management of that subsidiary, the effect of which being that the acquisition and holding of shares in that subsidiary are considered economic activities and, if so, under what conditions ?

Marle Participations case, C-320/17, 5 July 2018

3) Reasoning of the Court

- As a result, a holding company which provides property lease activities to its subsidiaries should be considered to be involved in the management of its subsidiaries if:
    - the supply of letting services is made **on a continuing basis**
    - the supply is **taxable**
    - it is carried out **for consideration**
    - a **direct link** exists between the services rendered and the considerations received
- When assessing any limitation of the input VAT deduction right of a holding company, any **disproportion** between the revenue generated and the amount of fees incurred should not be taken into account.
- Holdings involved in the management **only of some** subsidiaries: expenses connected with the transactions in subsidiaries' shares should only be regarded as partially belonging to the general expenses (the deduction of input VAT on such expenses should be limited accordingly).
- While assessing the input VAT deduction right, any other revenue generated (such as VAT exempt financial income not entitling to an input VAT deduction) should be taken into account.

Marle Participations case, C-320/17, 5 July 2018

4) Decision of the Court

“The letting of a building by a holding company to its subsidiary amounts to ‘involvement in the management’ of that subsidiary and must be considered to be an economic activity, giving rise to the right to deduct the VAT on the expenditure incurred by the company for the purpose of acquiring shares in that subsidiary, where that supply of services is made on a continuing basis, is carried out for consideration and is taxed, meaning that the letting is not exempt, and there is a direct link between the service rendered by the supplier and the consideration received from the beneficiary.”

Marle Participations case, C-320/17, 5 July 2018

5) Implications

- The VAT deduction of active holding companies may be summarized as follows:

  i. involvement in the management of subsidiaries can be achieved through the permanent **performance of any kind of economic activity** (if taxable and duly remunerated). The notion of “involvement in the subsidiary’s’ management” should be understood as covering any type of transactions constituting a taxable economic activity (such as taxable property lease activities as in the case at hand);

  ii. if a holding company is involved in the management **of all its subsidiaries**, it should benefit from a full input VAT deduction right **in respect of general expenses** (e.g. expenses incurred in relation to the acquisition of subsidiaries’ shares); and

  iii. provided the conditions are met, holding companies should benefit from a full input VAT deduction right on acquisition costs**, irrespective of the result of their economic activity** (i.e. with no regard to the importance of the taxable turnover compared to the general expenses).

  To be compared with the usual “1 to 1” principle applied by the VAT authorities.

3. Ryanair case, C-249/17, 17 Oct 2018

Ryanair case, C-249/17, 17 October 2018

1) Background of the case

- Ryanair made a bid to take over a competitor, the Irish airline Aer Lingus. The takeover failed because of competition law considerations. Ryanair claimed deduction of the input VAT paid on consultancy and other services in connection with this takeover. The Irish VAT authorities refused it.

2) Questions referred for a preliminary ruling

- Can a **future intention to provide management services** to a takeover target, in the event that the takeover is successful, be sufficient to establish that the potential acquirer is engaged in economic activity ?

- Can there be a sufficient **"direct and immediate link" between the professional services received and output, the potential provision of management** to the acquisition target to permit a deduction to be made ?

Ryanair case, C-249/17, 17 October 2018

3) Reasoning of the Court

- The services at issue were provided to Ryanair when it **intended**, by the planned acquisition of shares in the target company, to pursue an economic activity consisting in providing to that company management services subject to VAT.
    - Thus Ryanair acted as a taxable person at the time it incurred the consultancy services.
    - By doing so, it benefits, in principle, from the right to deduct VAT immediately, even if, ultimately, that economic activity, which was to give rise to taxable transactions, was not carried out and, accordingly, did not give rise to such transactions.

- Conditions for the exercise of the right to deduct:
    - The expenditure incurred for the purpose of the acquisition of the shares of the target company must be regarded as being **attributable to the performance of that economic activity** which consisted in carrying out transactions giving rise to a right to deduct.
    - On that basis, that expenditure has a **direct and immediate link** with that economic activity as a whole and, consequently, is part of its general costs. It follows that the corresponding VAT is deductible in full.

Ryanair case, C-249/17, 17 October 2018

4) Decision of the Court

"A company which intends to acquire all the shares of another company in order to pursue an economic activity consisting in the provision of management services subject to VAT to that other company, has the right to deduct, in full, input VAT paid on expenditure relating to consultancy services provided in the context of a takeover bid, even if ultimately that economic activity was not carried out, provided that the <u>exclusive reason</u> for that expenditure is to be found in the intended economic activity."

4. C&D Foods case, C-502/17, 8 Nov 2018

C&D Foods case, C-502/17, 8 November 2018

1) Background of the case

- C&D Foods carried out 2 activities : the holding of shares in its subsidiary and the provision of taxable management and IT services to its sub-subsidiary. Because of financial difficulties, Kaupthing Bank assumed ownership of C&D Foods group, would like to restructure the group and, in this context, **intends to sell the shares of its sub-subsidiary**. To this end, C&D Foods, at the request of Kaupthing Bank, incurred legal and audit costs and sought to recover the input VAT on such costs (even though the sale ultimately never took place). The Danish VAT authorities refused it.

2) Questions referred for a preliminary ruling

- Is a holding company entitled to a full deduction of VAT on services related to due diligence investigations before an envisaged, but **not completed, sale of shares** in a subsidiary to which the holding company supplies management and IT services that are subject to VAT ?

C&D Foods case, C-502/17, 8 November 2018

3) Reasoning of the Court

- The sale of shares, in itself, **does not constitute an economic activity**, implying that no deduction of input VAT on related costs can be granted.

- However, if the **direct and exclusive reason** for the share sale relates to the taxable activity of the parent company, or constitutes a **direct, permanent and necessary extension of the parent company's taxable activity**, a VAT deduction right may be recognized.
  - E.g. a sale of shares is carried out with the purpose of allocating the proceeds directly to the taxable activity of the parent company or to the economic activity carried out by the group.

- In the C&D Food case, the objective of the sale of shares was to settle the bank debts. Such a sale could not be viewed as being performed for the purposes of the taxable activities of C&D Foods.

- Compared to previous ECJ case law (such as *BLP case C-4/94*), VAT deduction on share disposal costs is now possible in specific circumstances.
  - Attention should be paid to the **underlying purpose** of the transaction in order to determine the VAT recovery right on share disposal costs

C&D Foods case, C-502/17, 8 November 2018

4) Decision of the Court

“a share disposal transaction, envisaged but not carried out, for which the direct and exclusive reason does not lie in the taxable economic activity of the company concerned, or which does not constitute the direct, permanent and necessary extension of that economic activity, does not come within the scope of VAT”

According to the ECJ, which input VAT is recoverable for holding companies ?

1) Acquisition costs

- In principle, **NO**
  → A holding company does not have the status of taxable person and, accordingly, does not have the right to deduct VAT.

- However, **YES** (at least partially)
  → If the holding company carries out (or intends to carry out), on a continuing basis, any transaction constituting a taxable economic activity to all concerned subsidiaries.

2) Disposal costs

- In principle, **NO**
  → The sale of shares, in itself, does not constitute an economic activity: no deduction of input VAT on related costs can be granted.

- However, **YES**
  → If the direct and exclusive reason for the share sale relates to the taxable activity of the parent company, or constitutes a direct, permanent and necessary extension of the parent company's taxable activity.

3) Aborted deal costs : "Intention" is key when considering VAT recovery entitlement

Luxembourg position

- Longstanding restrictive approach as regards the input VAT recovery right of (active) holding companies
- Local cases ruled in 2017, i.e. prior to Marle case law, and which can be summarized as follows:

1. "One for one" rule : input VAT recoverable limited to the amount of VAT that would have been applied to the "recharged" costs.
2. "Cost components of output transactions and burden of proof": no input VAT recovery for an "active holding company" for the VAT incurred on costs related to specific projects regarding capital-restructuring transactions, on the grounds that the taxpayer did not provide enough proof that these costs were price components of the output transactions allowing input VAT recovery.

- Recent decisions issued in 2018 by the Direction of the Lux. VAT authorities in similar cases:

  - the costs incurred need to be "approximatively" **reflected in the output price**
  - reasonable range needs to be maintained between the costs incurred and the amount of taxable turnover: **the "mirroring VAT deduction" rule**
    - It can be calculated/evaluated over several years, i.e. one negative year can be offset with a positive subsequent year.

Proposals adopted by the EU Economic and Financial Affairs Council (ECOFIN)

Meeting of 2 Oct 2018

« Quick fixes » - January 2020

1. Intra-community supply of goods

- Currently , intra-community supplies of goods between two taxable persons (“B2B relations”) are **exempt from VAT in the Member State of departure of the goods**

- The seller must be in position to **prove** to the VAT authorities of the Member State of departure that the goods have actually **left its territory**.

- The Council want to standardize these means of evidence:

  1. To strengthen the role of the **VAT number** : from the 1st January 2020, it will become a substantive requirement

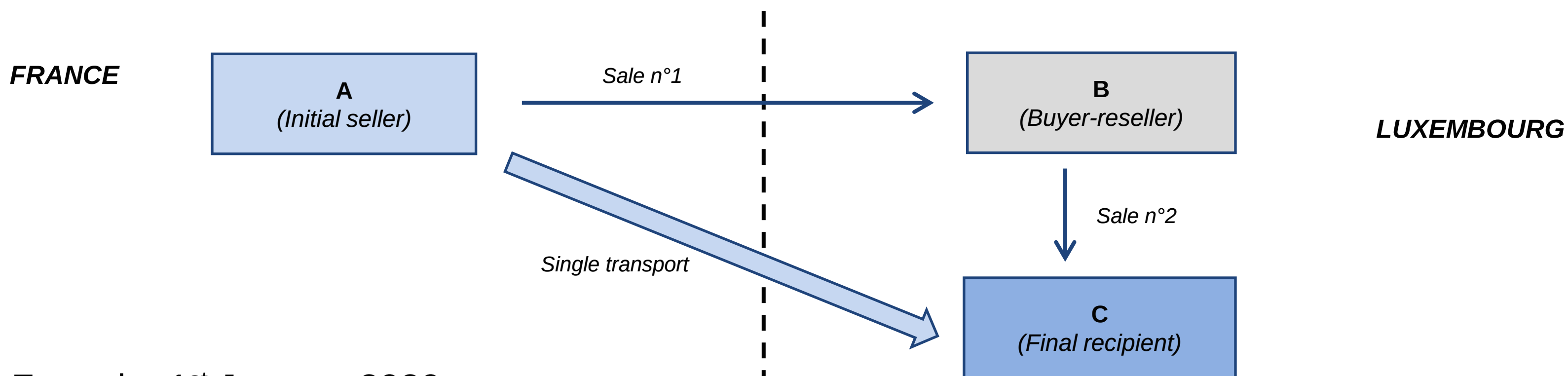
  2. The **combination of min. two means of evidence** (exhaustive listing):
     Examples: bill of lading, transport insurance policy, banking documents supporting the payment of the transport, deposit waybill, air freight invoice, sea freight invoice, etc.

« Quick fixes » - January 2020

2. Chain transactions

- Chain transactions = **successive** supplies of the same goods which are the subject of **<u>one single</u>** intra-community transport

- According to the VAT regime, the single transport can be assigned only to one supply of goods pursuant to different rules. This designated supply of goods is the one entitled to benefit from the VAT exemption applicable to intra-community supply of goods.

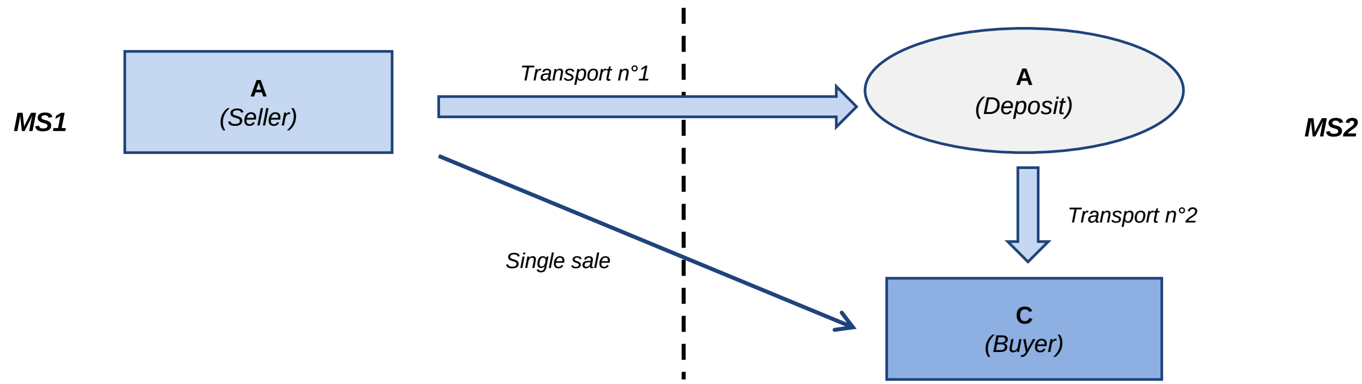


- From the 1st January 2020 :
  - The supply which will benefit from the VAT exemption is mandatorily the Sale n°1 between A and B
  - Except if B is registered from VAT purposes in the Member States of departure (at the case at hand, France)

« Quick fixes » - January 2020

3. Call-off stock

- Call-off stock correspond to the situation where, at the time of the transport of goods to another EU Member State, the supplier **already knows the identity of the buyer** but the goods will only be **delivered to him after their arrival** in the Member State of destination and according to his needs.



- Currently, we should track the different transports of goods to determine the VAT treatment :
  1. A intra-community supply of goods exempted from VAT in MS1 and subject to VAT in MS2 as an intra-community acquisition of goods (implying the VAT registration of A in MS2)
  2. A local resale subject to VAT in MS2

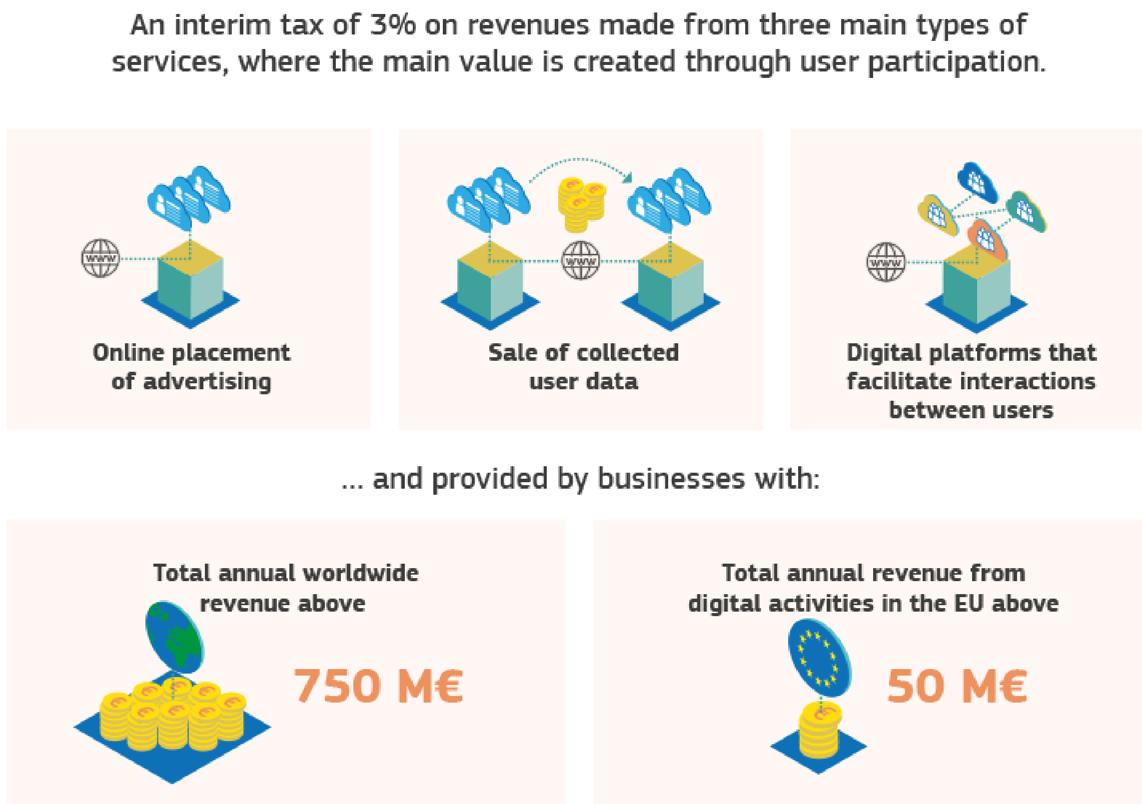
- From the 1st January 2020, it will be treated directly as **one single intra-community supply** of goods exempted from VAT in MS1 and subject to VAT in MS2 between "A" and "C" (so avoiding the VAT registration of A in MS2).

Taxes in 2019 and beyond

1. EU dimension

Two proposed directives on digital taxation

the first one as a temporary measure….



Two proposed directives on digital taxation

the second one as a final measure….

Where to tax?

Under the proposed new rules, companies would have to pay tax in each Member State where they have a significant digital presence, reaching **one** of the following thresholds:

- **Revenues from supplying digital services exceeding** €7 million
- **Number of users exceeding** 100,000
- **Number of online business contracts exceeding** 3,000

What to tax?

The attribution of profit will take into account the market values of:

- **Profits from user data** (e.g. placement of advertising)
- **Services connecting users** (e.g. online marketplace, platforms for "sharing economy")
- **Other digital services** (e.g. subscription to streaming services)

DAC 6

Mandatory disclosure rules

CCTB

CCCTB

2. OECD dimension

Importance of multilateralism

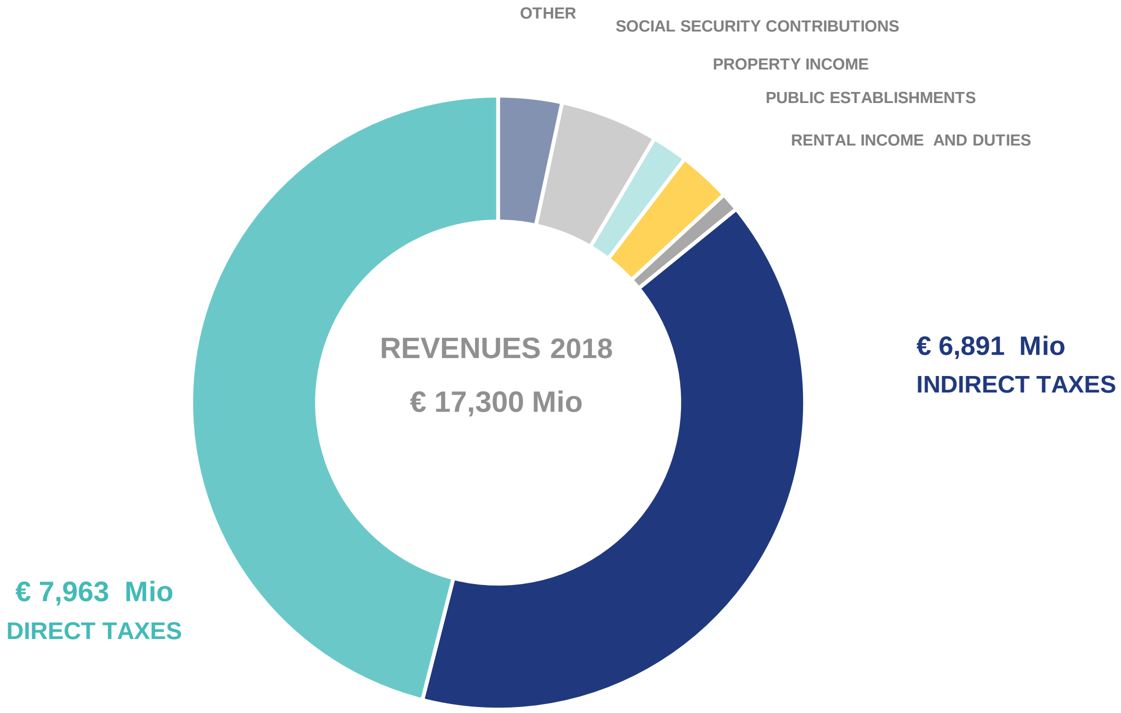
US tax reform

Digital taxation:

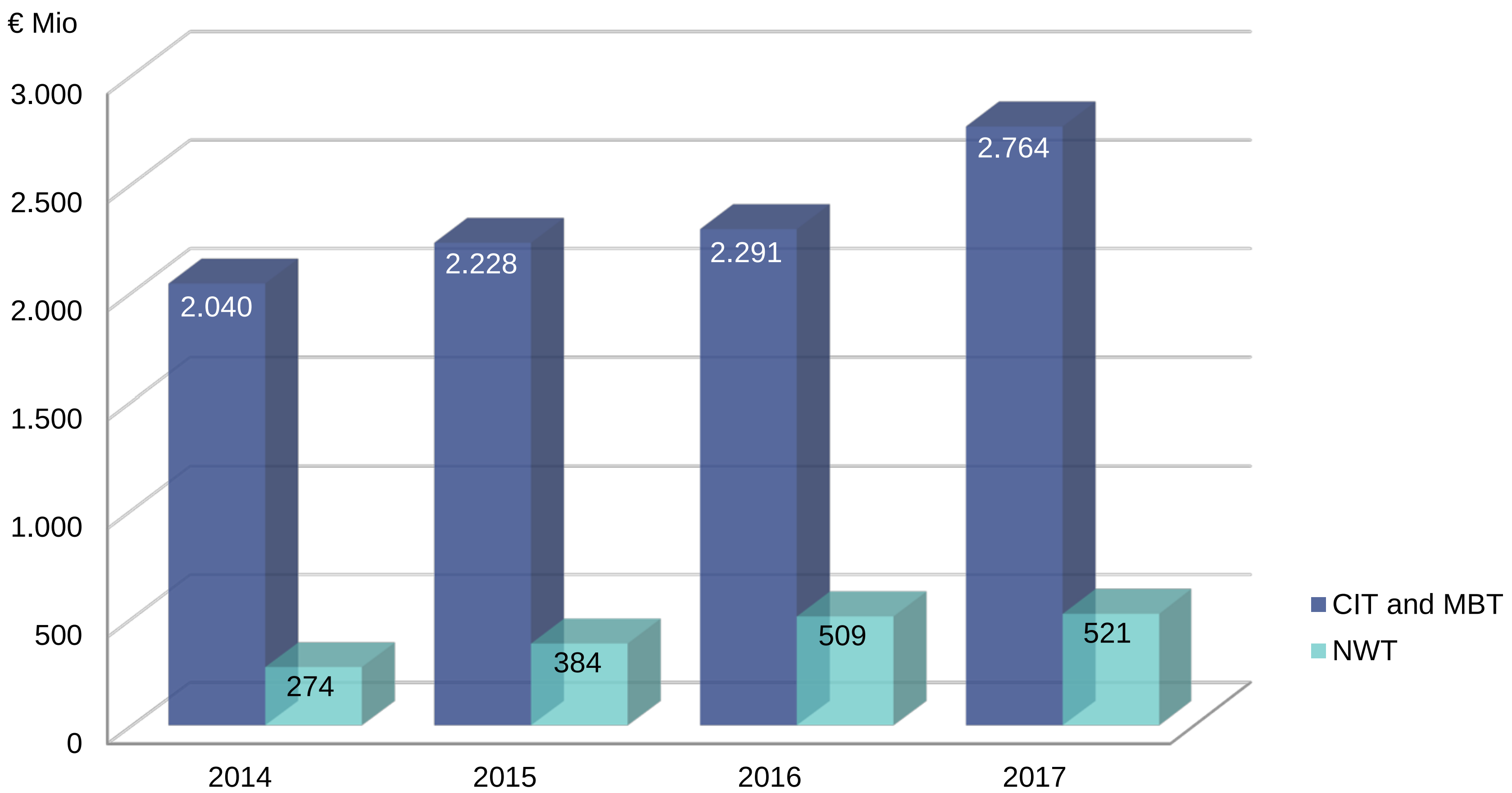
No, limited or global changes ?

3. Luxembourg dimension

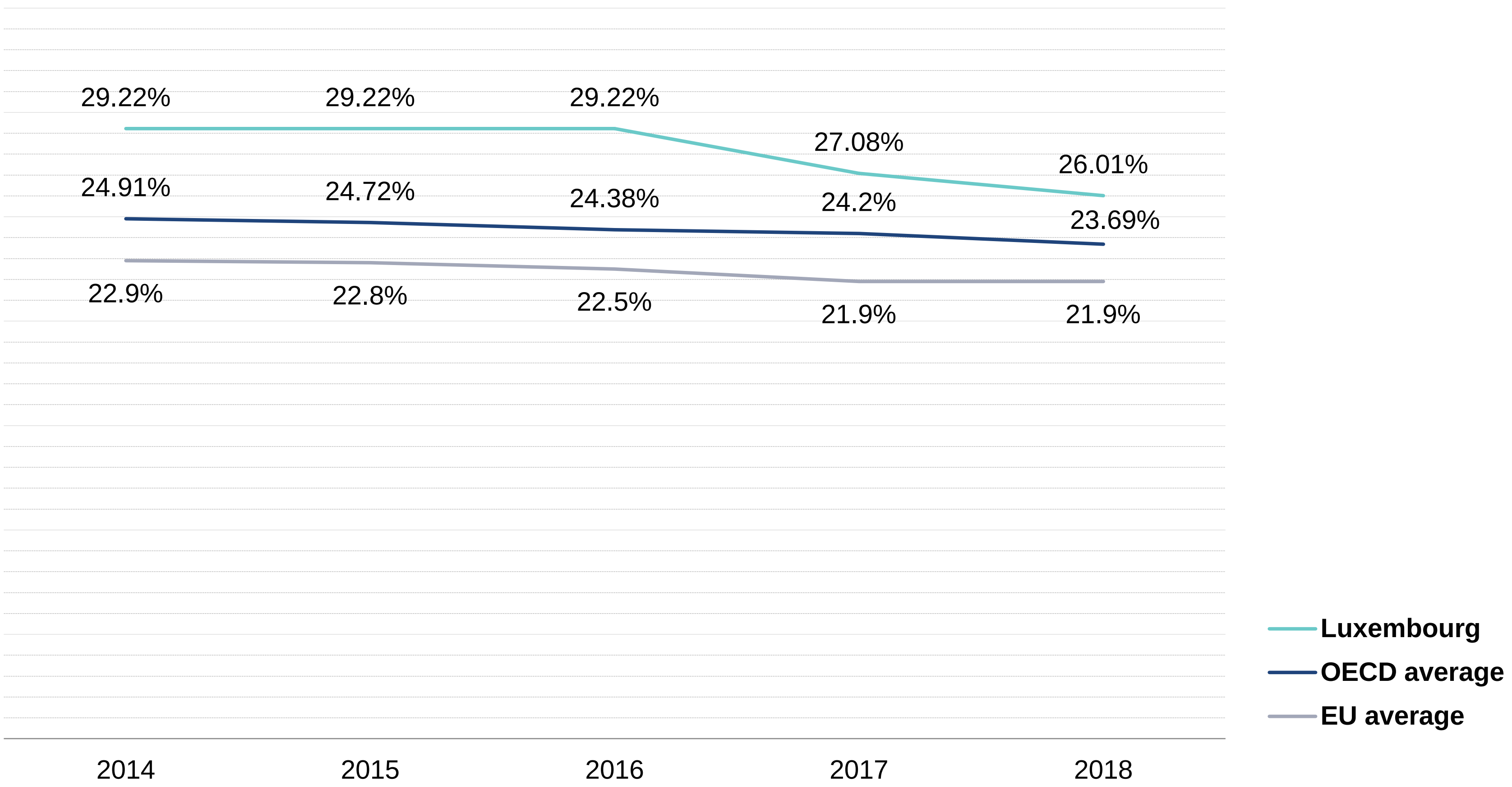
Luxembourg budget



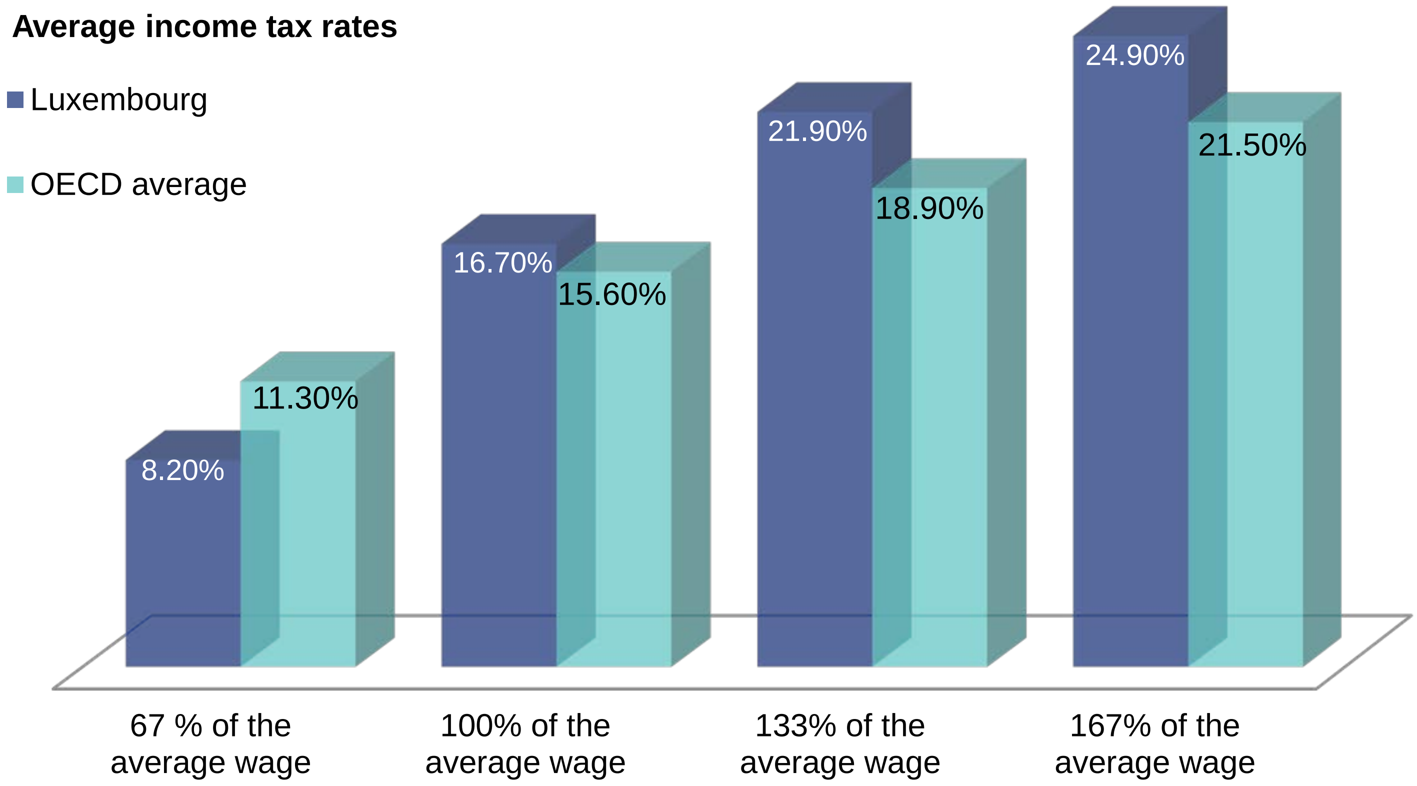
Corporate taxation: evolution of revenues from corporate taxes



Corporate taxation: Luxembourg vs. OECD / EU average rates



Individual taxation: average income tax rates in 2017



TENTATIVE CONCLUSIONS ?

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