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EU and Tax Policy Report

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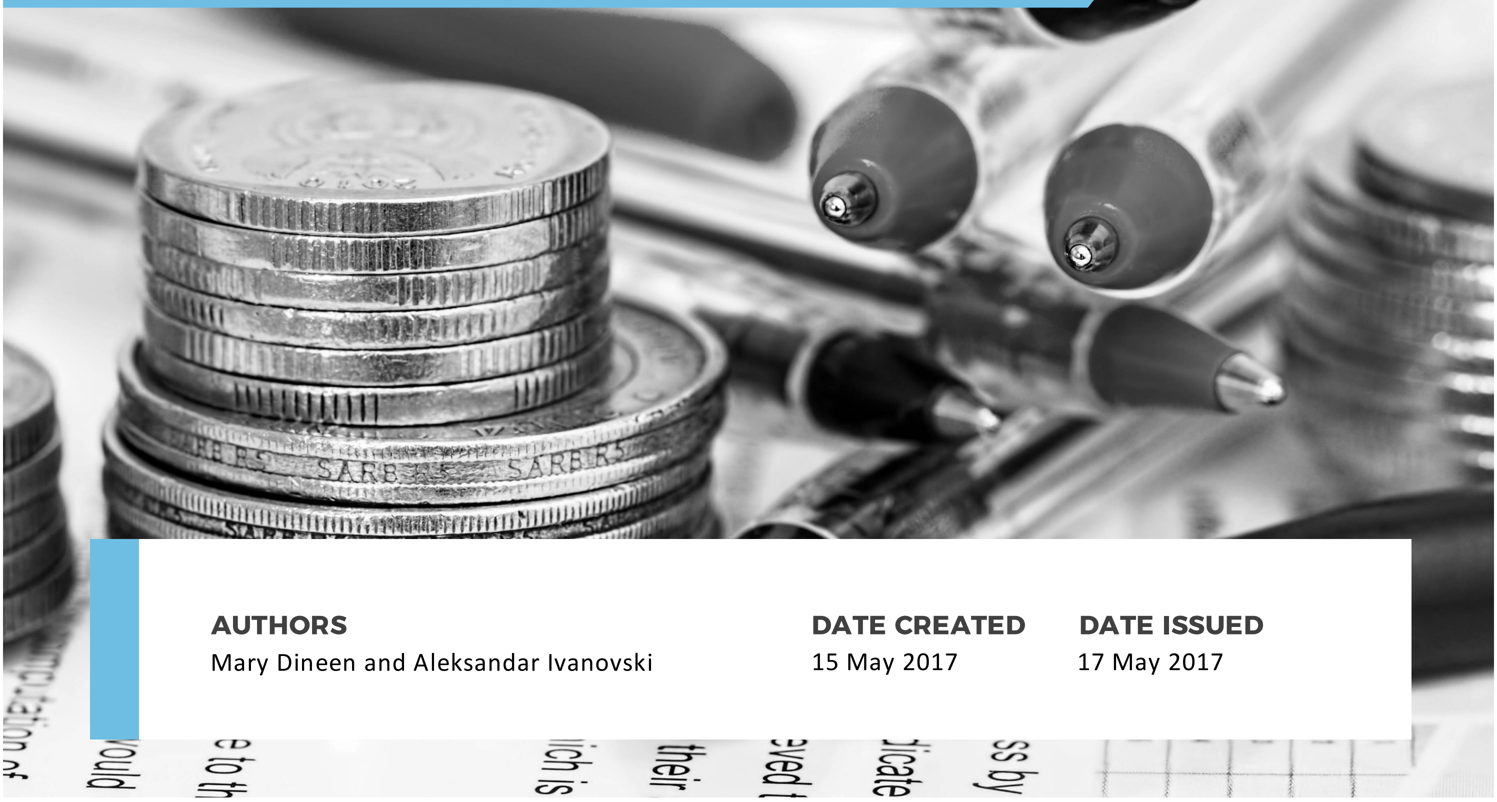
CFE is the leading European association of tax advisers



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CFE's EU and Tax Policy Report provides a detailed analysis of key tax and other policy issues at EU level of interest to the European tax advisers. It also includes an overview of selected CJEU case-law and relevant European Commission decisions covering the period January through May 2017.

Highlights

The Maltese Presidency will end in June and be succeeded by Estonia. Over the past six months, significant progress has been made in the areas of improving dispute resolution mechanisms for double taxation disputes and reaching agreement on the ATAD 2. Progress has been slower in relation the recast Interest and Royalty's Directive and the proposals for a relaunch of the common consolidated corporate tax base. Finally, the proposals on public country-by-country reporting suffered a setback but are subject of discussions on 17 May so it will be interesting to see what direction this file takes.

On the indirect taxation front, the last 6 months has seen four Commission public consultations being carried out, and in a statement on 12 April, Commissioner Moscovici confirmed that the European Commission is planning to propose an important overhaul of the EU VAT rules in September 2017. VAT practitioners have been closely monitoring the Opinions of the Advocate Generals in recent months where divergent views have been espoused in relation to the application of the VAT exemption for the cost-sharing associations in the financial services sector.

Commissioner Moscovici confirmed earlier in May speaking to the European Parliament 'PANA' Committee that a legislative proposal on the 'intermediaries' can be expected by the summer. Mr Moscovici also highlighted that the European Commission is working with the Council on establishment of 'blacklist' of non-cooperative jurisdictions for tax purposes by end of year.

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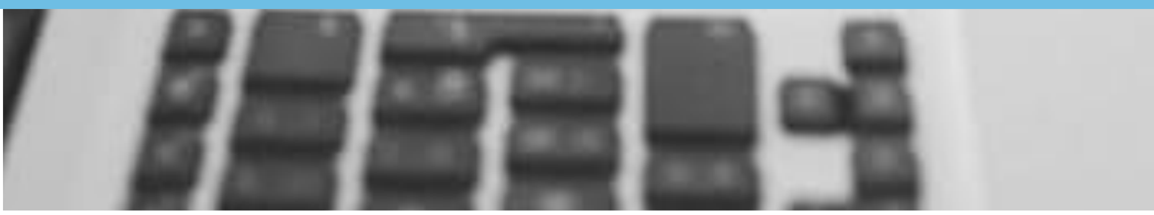


Moscovici confirms details on the 'intermediaries'

On Thursday 4 May the European Parliament "PANA" Committee of Inquiry held a public hearing with EU Commissioner Pierre Moscovici. Commissioner Moscovici discussed the details of the upcoming EU legislative proposal on disincentives for intermediaries of aggressive tax planning schemes, the forthcoming EU blacklist of non-cooperative jurisdictions for tax purposes and the recent exchanges between the European Commission and the US. Speaking to MEPs, the Commissioner said that he expects the legislative proposal from the Commission by June. Mr Moscovici also confirmed that the Commission is considering a legislative proposal, rather than a 'soft-law' instrument such as *Code of conduct*, which would include 'all intermediaries, and would cover all harmful practices and all jurisdictions'.

In respect of this policy initiative of the European Commission, CFE adopted an Opinion Statement PAC/FC 1/2017. Below is the Executive Summary:

- CFE highlights the positive role of the tax advisers in Europe and their contribution to the rule of law- tax advisers play a fundamental role in making complex tax systems work;
- Considering the intrinsic complexity of tax systems, any envisaged disclosure regime must not undermine the ability of taxpayers to seek advice and tax advisers to provide it;
- CFE supports Commission's efforts for improved tax transparency – by doing so, the EU should seek to implement OECD recommendations, in particular Action Point 12, in a coordinated way to ensure level-playing field within the EU;
- In respect of the objectives of this policy initiative, CFE believes that the EU should continue to facilitate administrative cooperation between Member states to tackle cross-border abuse and to improve voluntary compliance of taxpayers by introducing reassurances on the fairness of the tax system;
- While mandatory disclosure regime could be a useful instrument for provision to the tax authorities of information about tax arrangements that might undermine the integrity of the tax system, CFE believes that the European Commission should take into account the principle of subsidiarity and the need for intervention at EU level, considering that several EU Member states have already introduced mandatory disclosure regimes;
- Any disclosure obligations should take into account the right against self-incrimination; any upcoming proposal should include exemption for tax advisers similar to the one laid down in Article 34(2) of the Anti-Money Laundering Directive;
- The country-specific scope of the right of non-disclosure and confidentiality, as well as professional privilege, need to be respected in any future proposal in light of the diverse regulatory ambient for the tax profession in Europe;
- Excessively burdensome mandatory disclosure rules at EU level could potentially decrease the attractiveness of the EU Internal market, which could run affront to the efforts of making the EU the most dynamic and innovative market in the world.

European Parliament Developments

02

European Parliament 'PANA' Committee of Inquiry Update

The more assertive European Parliament has had quite a prominent role in driving forward or influencing the EU tax policy agenda in the past months. The Committee of Inquiry into Money Laundering, Tax Avoidance and Tax Evasion 'PANA' held a series of public hearings and evidence gathering sessions in the first half of the year.

The PANA Committee adopted a preliminary report Working Document of 15 December 2016 which discussed the scope of the Panama revelations, main offshore constructions and the degree of opacity identified from such structures, as well as contraventions to EU law stemming from the revelations. The Working Document pointed to the significant role played by the intermediaries in setting up schemes to hide the identity of the ultimate beneficial owner ("UBO") in respect of off-shore structures.

One of the aims of the European Parliament's PANA inquiry process, according to the Working Document, is to have a clear assessment, by the end of the process, of the extent to which the professionals such as lawyers, accountants or advisers are regulated or self-regulated, and whether their conduct rules are adhered to in practice. In respect of tax advisers, consultants, lawyers and auditors, the MEPs used the evidence hearings to familiarise themselves with the different codes of conduct that are in place, and their *modus operandi* in relation to identification of suspicious transactions.

This process was followed by a series of public hearings, where representatives of different interest groups were invited to give evidence to the PANA Committee of Inquiry. Some of the discussants at the January 2016 public hearing (ie. Ronan Palan, Tax Justice Network, Brooke Harrington, Copenhagen Business School) pointed to the role of intermediaries in facilitation of structures that are in contravention to the spirit of the law. The follow-up session of the public hearing 'The Role of Lawyers, Accountants and Bankers in Panama Papers' was mainly devoted to the banking sector inquiry, banks' transparency and compliance practices, as imposed by the EU anti-money laundering legislation and FATF standards, as well as the role of intermediaries in facilitation of tax evasion and tax avoidance. Specific focus of the public hearing were the German and Scandinavian banking operations (Berenberg bank, Association of German banks, Nordea etc.). During these discussions, the MEPs called for crackdown on secrecy and establishment of more transparent tax systems and, strengthened the cooperation between the tax authorities across the European Union.

The Committee of Inquiry discussed in April and May 2017 the findings of three studies that the European Parliament had commissioned on the impact of the offshore money-laundering and tax evasion practices on EU Member States' exchequers and public finances, and, the assessment on the performance of Member States' taxation and judicial administrations in addressing the issues stemming from the tax evasion, tax avoidance and money laundering practices.

EU Tax Policy – Direct Tax

03

Agreement reached at ECOFIN on the "ATAD 2"

On Tuesday 21 February, the Council of the European Union ("the Council") reached agreement on the finalised text of the Directive extending the scope of the original Anti-Tax Avoidance Directive (the "ATAD"). The "ATAD 2" will extend the scope of the ATAD to include hybrid mismatches involving non-EU Member States and will tackle specific hybrid scenarios, for example those relating to permanent establishments, dual-resident entities and hybrid financial instruments.

Although broad consensus was reached at the December meeting of the Council, contention still existed over two carve-outs and the implementation deadline. The ATAD has an implementation deadline of 31 December 2018 whereas ATAD 2 will for the most part have a deadline of 31 December 2019 as part of the final compromise.

The European Parliament adopted its Opinion on 27 April 2017. The Parliament's Opinion will be sent back to the Council for final approval. The Rapporteur has stated that the "*proposed directive is a fundamental step in to counter hybrid mismatches involving third countries in order to neutralize hybrid mismatch arrangements*".

In the context of reverse hybrid mismatches which arise when the hybrid entity is located in a Member State, it was agreed that the reverse hybrid entity will be regarded as tax resident in that Member State and taxed on the income that is not otherwise subject to tax. The reverse hybrid provisions will not apply to recognised collective investment vehicles.

The two carve-outs related to hybrid regulatory capital and financial traders were also agreed. In relation to hybrid regulatory capital a carve-out will exist until 31 December 2022 whereby Member States can provide an exemption for intra-group instruments that have been issued with the sole purpose of meeting the issuer's loss-absorbing capacity requirements whereby it is not done in pursuance of avoiding tax or under a structured arrangement. The compromise text approach to financial traders bring it more in line with BEPS Action 2 and is focused more on a delimited approach rather than retaining a specific exemption.

Country-by-Country Reporting Update

In stark contrast to the progress being made on finalising the work on hybrid mismatches, the proposals on public country-by-country reporting ("CbCR") came to a grinding halt when the Opinion of the Legal Service of the Council issued at the end of 2016. The Opinion concluded that public county-by-country reporting was a taxation matter and not a matter falling within the ambit of the Accounting Directive, as was initially found by Commission legal services. The Opinion is based on the premise that the purpose of the proposals is the protection of the functioning of the internal market and prevention of tax avoidance rather that the protection of shareholders and the public under Article 50 TFEU.

In order for the public CbCR proposals to be characterised a "tax file" by the EU Commission, Member States must unanimously request that the Commission do so, therefore the Legal Opinion alone has limited practical consequences without subsequent action. No action has been taken and Member States are still assessing the situation and the Maltese Presidency is taking a "wait and see" approach.

At Council level, Germany is the main detractor behind the scenes, with France the main proponent of the proposals. This is interesting in light of the decision (Decision 2016-741) of the French constitutional court, which found that public country-by-country reporting was contrary to the constitution. The decision related to the legislation enacted in France to introduce public country-by-country reporting. Whilst the Court recognised that the purpose of public country-by-country reporting obligations is tackling fiscal fraud and tax avoidance, it concluded that the legislation was contrary to the principles of proportionality, going beyond what was necessary to achieve the aim of the legislation.

The European Parliament appears to be maintaining its steadfast support and went a step further in its Opinion. The Rapporteurs propose the reduction of the 750 million euro threshold to 40 million and extending the scope of the publication of the information beyond that relating to EU countries to every country in which they operate.

The next Working Party Meeting is scheduled for 17 May, where a new Malteese presidency compromise text will be discussed.

Recast Interest & Royalties Directive

The Maltese presidency took up the baton to progress work on a recast of the Interest and Royalties Directive. The proposals date back to 2011 but were stalled in Council in 2012. The main point of contention is the proposal to introduce a minimum effective taxation clause, which seven Member States opposed in 2012.

Malta has drafted compromise texts in order to alleviate concerns of those Member States in an attempt progress the issue. The compromise text proposed an amendment that would allow the source member state to exclude the provisions of the directive when the payment relates to a preferential tax regime. In this regard, an issue of particular concern is the inclusion of patent boxes under preferential regimes. It is reported that the Netherlands proposed removing patent boxes that comply with the modified nexus approach of the OECD.

Bloomberg reported (Article May 9 2017) that the compromise text also includes the insertion of a subject-to-tax clause and a targeted anti-abuse rule similar to that contained in the EU parent-Subsidiary Directive. Some Member States believe that any concerns can be met by the new anti-abuse provisions being introduced pursuant to the Anti-Tax Avoidance Directive, which include provisions to limit interest on deductions, as well as CFC rules.

Tax Certainty – Attracting Attention at EU Level

Tax certainty was identified as a priority of the G20 back in July 2016. Consequently, the OECD/IMF presented a Report on Tax Certainty in March 2017 to the G20. The topic has more recently reached the EU Agenda, with an EU Commission Taxation Paper published on tax uncertainty in April 2017. The topic came to the forefront of the Maltese Presidency when an internal document seeking to compel a discussion on the subject at the informal ECOFIN meeting on 7 and 8 April was published in some media outlets, and attracted criticism. In the internal working document, the Maltase Presidency stated the downside of such major and rapid changes is that taxpayers and tax administrations may experience uncertainty. It also states, "*The rapid introduction of numerous process of tax legislation in quick succession could introduce elements of legal uncertainty in their interpretation implementation and application*."

Malta's Minister for Finance, and head of ECOFIN emphasised the importance of tax certainty and the need for the EU to enhance tax certainty so that multinationals can understand ahead of time how their EU investments will be treated. He dismissed any suggestions that encouraging tax certainty in any way conflicts with implementing proposals to combat tax avoidance.

The Commission Taxation Paper concludes that tax uncertainty derives from many national and international sources but weaknesses in the institutional framework of tax policy is the primary cause. At a domestic level, the report cites typical sources of uncertainty as being the lack of precision of the tax code and frequent tax changes. An additional source of tax uncertainty stems from the overall political and administrative process of pursuing a tax reform: from the announcement and preparation, to the implementation and the following fine-tuning.

At the international level, the lack of tax coordination/cooperation between countries, as well as the globalization and the emergence of new business models, are the main reasons of increased tax uncertainty regarding the tax treatment of cross-border investment.

The Paper identifies the simplification of the tax system as the main remedy to tax uncertainty and opines that the BEPS initiative and the EU agenda to fight aggressive tax planning are promoting more coordination among governments should result in greater tax certainty.

Dispute Resolution Mechnisms

The progression of the proposed Directive on Double Taxation Dispute Resolution Mechanisms (the "Proposed Directive") in the EU has been a top priority of the Maltese Presidency, with a major push to see a finalised text issue by the end of May. There is consensus amongst stakeholders that the existing mechanisms are insufficient to satisfy the needs of taxpayers. It has become a major tax obstacle to cross-border investment and a contributing factor to increased tax uncertainty. This is evidenced by the Commission indication that there are currently around 900 double taxation disputes in the EU with EUR 10.5 billion at stake. The Parliament is in favour of the Proposed Directive but suggest going further in come aspects. In the Draft Opinion of ECON presented to the Parliament in March 2017, further steps were encouraged such as acceleration of some time limits and the employment of the necessary resources by Member States to effectively implement the changes. In addition, the report recommends that the Commission review the functioning of the new rules within five years and then assess the possibility of extending its scope to cover other areas of taxation, such as indirect taxes, personal income taxes, or inheritance taxes.

The Proposed Directive will build upon the existing mechanisms provided under the Union Arbitration Convention broadening the scope, streamlining the process and ensuring effective resolution for business in order to facilitate tax and legal certainty in the Union. In addition, measures to improve tax certainty, such as the publication of decisions (subject to taxpayer approval) is included. The Draft Opinion of ECON suggests the creation of a centrally managed website containing all published decisions.

Under the Proposed Directive the scope will be increased to include all cross-border issues in the context of business profits. Resolution of disputes will be mandatory and subject to strict and enforceable timelines. The Draft Opinion of ECON goes further on the proposed time limits and encourages shorter time periods for some of the procedural stages. One of the salient improvements under the Proposed Directive is the inclusion of an additional layer of protection in the form of an automatic and mandatory arbitration procedure to be completed within fifteen months in the event that the Member States fail to reach a conclusion to the initial MAP phase.

The proposed Directive seeks to empower the taxpayer and strengthen their role in the process. Taxpayers have always had the right to institute proceedings. However, the Proposed Directive seeks to empower the taxpayer during the process, for example, by notifying them of the terms of reference of the dispute, the proposed timeframe for completion and the terms of conditions of taxpayers' or a third parties involvement.

The text is anticipated to be finalised by the Council at the ECOFIN meeting on 23 May. In addition, a vote is scheduled in Parliament on adopting the draft Report as an Opinion of the Parliament for 8 June. As this is a taxation matter, sole competence rests with the Council and the Parliament Opinion will not be binding.

EU Tax Policy – Indirect Tax

04

VAT Public Consultations

The European Commission has launched numerous public consultations in 2017 with a view to reforming and modernising the VAT system in the EU. The consultations deal with the definitive VAT regime, reform of VAT rates, and special rules for small enterprises (SMEs). On 2 March a consultation was launched on the functioning of the administrative cooperation and fight against fraud in the field of VAT.

In a statement on 12 April, Commissioner Moscovici confirmed that the European Commission is planning to propose an important overhaul of the EU VAT rules in September 2017. It is outlined in the Sixth Progress Report on 12 April,, that the European Commission is planning to move on to a single VAT area in order to reduce weaknesses of the present system and to tackle cross-border VAT abuse, notably 'Missing Trader Intra-Community Fraud' or 'Carousel Fraud'.

EU Policy –

Anti- Money Laundering

05

Public Access to Beneficial Ownership Registers?

Anti-Money Laundering remained in the spotlight of the EU policy developments for much of the past months. After the Council had adopted a Presidency Compromise text on the amendments to the 4th Anti-Money Laundering Directive (EU) 2015/849 in December 2016, the European Parliament's Committee on Economic and Monetary Affairs Committee ('ECON') and the Committee on Civil Liberties, Justice and Home Affairs had voted in March 2017 to amend the proposal to allow access of the general public to the beneficial ownership register. Under the present rules, the access to the AML beneficial ownership registers was limited to official authorities. The European Parliament's proposed solution would allow European citizens to access beneficial ownership registers without having to demonstrate a legitimate interest in the information.

The trilateral negotiations on the amendments between the Council, the European Commission and the European Parliament continued in May. The Parliamentarians voted (see the Report of 9 March 2017 to extend the scope of the 4th Anti-Money Laundering Directive to cover trusts and other types of legal arrangements having a structure or functions similar to trusts, which were previously excluded from the scope of the Anti-Money Laundering Directive on privacy grounds. Under the amendments, virtual currency platforms would also be within the scope of the EU Anti-Money Laundering Directive, having the same customer identification obligations as banks.

EU Supranational Risk Assessment

Simultaneously with the developments related to the legislative changes to the European Union Anti-Money Laundering legislation, the European Commission continued into the first-half of 2017 with the implementation of the 4th Anti-Money Laundering Directive. Pursuant to the mandate given by Article 6 of the Directive (EU) 2015/849, the European Commission is finalising the supranational risk assessment for legal professionals, tax advisers, accountants, high value good dealers and real estate agents. The European Commission shall draw up report identifying, analysing and evaluating the risks at European Union level. This report would imply measures at national or EU level.

The European Commission presented on 14 March 2017 a draft preliminary analysis, which was provided to relevant stakeholders, including the CFE. This private sector consultation meeting concerned the European Commission preliminary analysis on the risk scenario at EU level, as well as the mitigating measures prior to the European Commission drawing up a report which identifies and evaluates the risks at EU level pursuant to Article 6 of the 4th Anti-Money Laundering Directive, based on Article 114 of the TFEU.

The European Commission involved stakeholders from private sector and professional associations in order to gather feedback and raise awareness of the sector concerning the money laundering and terrorism financing risks. CFE submitted comments to the European Commission on the preliminary results of the Supranational Risk Assessment in October 2016, and additional remarks in March 2016 on the possible mitigating measures. According to the Roadmap published by the European Commission in February 2017, the Supranational Risk Assessment of legal professionals, TCPS, high value good dealers and real estate was part of an assessment based on risk approach which aims to ensure that resources and measures to prevent or mitigate money laundering and terrorism financing are appropriate to the identified risks. This analysis by the Commission was conducted based on the criteria of the methodology, i.e. on the threat component regarding the intent and capability for criminal organisations to use such scenarios, and on the vulnerability component regarding the risk exposure, the risk awareness, and the legal framework as well as controls put in place.

In respect of the possible measures that will mitigate the risks, CFE expressed in its submission to the European Commission support for the baseline scenario that would entail full implementation of the 4th AML Directive and welcomed proposals that guarantee proper enforcement of the legal provisions in force.

The European Commission Supranational Risk Assessment report pursuant to the 4th Anti-Money Laundering Directive is due for 26 June 2017.

EU Policy – Whistleblowers & EU 'Blacklist'

06

Public Consultation on whistleblowers

In February 2017, the European Parliament adopted a resolution calling for an “effective and comprehensive European whistleblower protection programme” to be proposed “immediately” by the Commission. MEPs “deplored Commission’s failure” to deliver a legislative proposal that establishes a minimum level of protection for whistleblowers who help to protect the EU’s financial interests”.

As a follow-up to European Parliament’s report, the Commission published in January 2017 an inception impact assessment, on the possibility to introduce horizontal or further sectoral EU measures on whistleblowers’ protection. The inception impact assessment was followed by a public consultation, running until 29 May 2017. A targeted consultation with the most relevant stakeholder will follow in addition to the ongoing public consultation.

EU Whistleblower service for wrongful business practices

The European Commission announced on 16 March 2017 a whistleblower service that would allow for individuals or business entities to files anonymous reports about wrongful business practices that might be in violation of EU competition law. The tool will primarily serve as instrument to provide the European Commission with information on anti-competitive practices such as antitrust violations, existences of secret cartels, price fixing and fixing of procurement procedures. The tool is envisaged to enhance Commission’s lenience programme, under which entities can report their own involvement in cartels in exchange for reduction of fine.

According to EU Competition Commissioner Margrethe Vestager: *"If people are concerned by business practices that they think are wrong, they can help put things right. Inside knowledge can be a powerful tool to help the Commission uncover cartels and other anti-competitive practices. With our new tool it is possible to provide information, while maintaining anonymity. Information can contribute to the success of our investigations quickly and more efficiently to the benefit of consumers and the EU's economy as a whole".*

EU 'blacklist' of non-cooperative jurisdictions for tax purposes by end of year

The Council of EU agreed on the need to establish an EU list of non-cooperative jurisdictions for tax purposes by the end of this year, based on the Council conclusions adopted in November 2016. The 8 November 2016 Council conclusions laid down the tax good governance criteria that should be used to screen jurisdictions, and, established guidelines for the screening. The established criteria are related to tax transparency, fair taxation and implementation of anti-BEPS measures. The Council of the EU (ECOFIN) also reached agreement on the scope of the application of the Criterion 2.2., as established by the Council in its criteria and process leading to the establishment of the EU list. Criterion 2.2. establishes that "a jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect economic activity in the jurisdiction."

The establishment of EU 'blacklist' of non-cooperative jurisdictions could be seen as a follow-up of the Panama Papers revelations. European Union's actions are taken in line with the OECD work in the Global Forum on tax transparency and exchange of information for tax purposes.

The EU Code of Conduct group, a body which was initially tasked with implementation of the EU Code of conduct on business taxation, is now responsible to oversee the screening process leading to establishment of the EU 'blacklist' of non-cooperative jurisdictions for tax purposes.

EU State Aid Update & European Commission Decisions/ Direct Tax

07

Gert - Jan Koopman confirmed upgrade of EU's Task Force Tax Planning Practices

The European Commission deputy Director General for State Aid, Gert-Jan Koopman, confirmed that the Task Force Tax Planning Practices had been upgraded into a new Unit within European Commission Directorate General for Competition. The Task Force Tax Planning Practices led by Max Lienemeyer is responsible for the State aid investigations into tax rulings and aggressive tax planning practices that might be in contravention to European Union law. The Commission has to date adopted decisions for recovery of tax in the cases of Apple (Ireland), Starbucks (The Netherlands), Fiat Finance (Luxembourg) and the Belgian Excess Profit ruling scheme. These decisions are under appeal at the Court of Justice of the European Union as final arbiter on the legality of European Commission's decisions, which does not however prevent recovery of the assessed tax. Cases in the pipeline include Amazon, McDonald's, and the most recent one - Engie (GDF Suez).

The European Commission published in June 2016 a Working Paper on the applicability of Article 107(1) of the Treaty on the Functioning of the European Union to tax ruling practices providing some guidance on for governments and practitioners. Specifically, the paper provides for clarification as to the applicability of the 'arm's length principle' to tax rulings from a State aid perspective.

Cases: *GDF Suez (Engie)* Discretionary Double-Non Taxation of Interest

Continuing its inquiries into tax rulings practices by EU member states the European Commission is still looking into Luxembourg's tax treatment of the GDF Suez group (Engie). The opening decision of the Commission was published on 5 January 2017.

The case concerns discretionary double non taxation of interest i.e. tax treatment of debt and equity in relation to zero-interest loans. The tax rulings that the Commission looks into allegedly treated two financial transactions as both debt and equity, which is inconsistent with the tax treatment of the said transactions. Such a treatment gave rise to double non-taxation, as the borrowers could significantly reduce their tax liability in Luxembourg by deducting deemed interest payments as expenses. Under the terms of convertible zero-interest coupon the borrower can record a provision for deemed interest payment without an interest payment actually taking place. Had the lender actually received interest payments it would have been subject to corporation tax, whilst the interest payments are tax deductible at the level of the borrower. This discretionary treatment of the deemed interest payments gave rise to double non-taxation, endorsed with tax rulings approved by the Luxembourg tax administration. With this case, the European Commission addresses the cases of inconsistent application of national tax law that gives rise to discretionary double-non taxation.

In similar vein, the Commission is already looking into McDonald's arrangements in Luxembourg, where the group's income was exempt from taxation on basis of confirmatory ruling that accepts existence of permanent establishment in the US, where the profits should have been subject to tax, in spite of the fact that they were reportedly not subject to tax in the US.

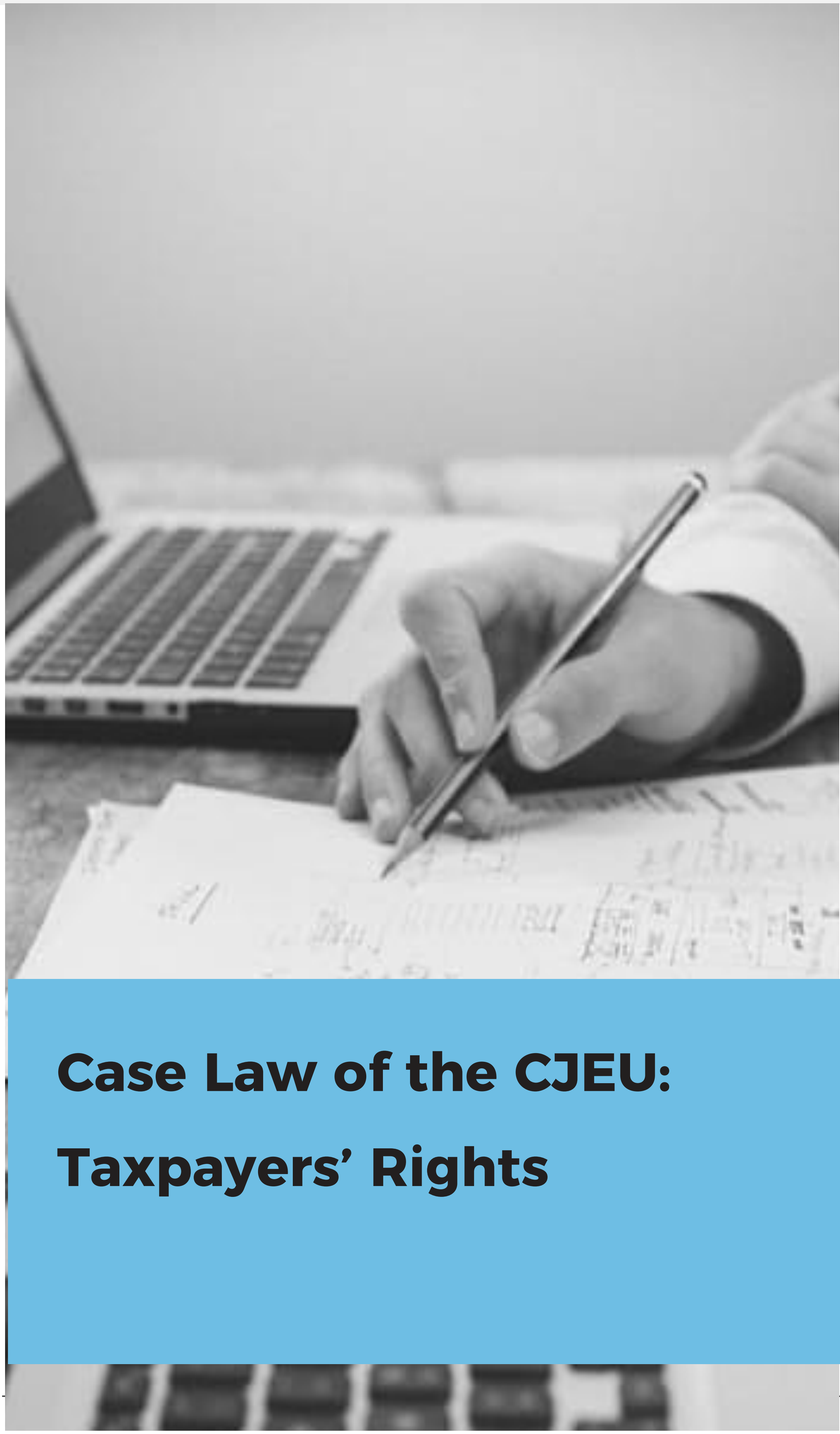
Apple: Arguments of the Commission and Ireland

The non-confidential version of European Commission decision related to the alleged State aid granted by Ireland to Apple was published in the Official Journal of the EU in March 2017. The European Commission decision states that Ireland granted Apple illegal State aid by virtue of the terms of two Advanced Pricing Arrangements (APAs) with two Apple entities in 1991 and 2007. The APAs were granted in relation to two subsidiaries of Apple Inc., Apple Sales International ("ASI") and Apple Operations Europe ("AOE") which were not tax resident in Ireland but operated through a branch in Ireland. The Commission issued its preliminary decision on 30 August 2016 after a three-year long investigation into Apple's tax arrangements in Ireland following comments made by Apple executives before a Senate Committee hearing in Washington in 2013. Ireland has appealed the decision and Apple has indicated its intention to appeal the decision. As a preemptive move Ireland published an outline of its appeal prior to the publication of the Commission decision. It is available here.

CFE published an extensive note summarising Commission's main arguments of 130 pages long ruling, which we summarise in the points below: The European Commission decision states that Ireland granted Apple illegal State aid by virtue of the terms of two Advanced Pricing Arrangements (APAs) with two Apple entities in 1991 and 2007. The APAs were granted in relation to two subsidiaries of Apple Inc., Apple Sales International ("ASI") and Apple Operations Europe("AOE") which were not tax resident in Ireland but operated through a branch in Ireland. The Commission issued its preliminary decision on 30 August 2016 after a three-year long investigation into Apple's tax arrangements in Ireland following comments made by Apple executives before a Senate Committee hearing in Washington in 2013. Ireland has appealed the decision and Apple has indicated its intention to appeal the decision. As a preemptive move Ireland published an outline of its appeal prior to the publication of the Commission decision. It is available here. Profit allocation methods were challenged by the Commission. The Commission found that the Irish Revenue i.e. Ireland's tax authorities granted Apple a "selective advantage" in contravention of EU State aid law because it did not employ appropriate profit allocation methods to calculate the Irish source income of the Irish branches. The Commission essentially disagrees with the methodologies employed by Apple and accepted by the Irish tax authorities, and in particular disagrees with: The use of a one sided functional analysis as opposed to a two-sided functional analysis assessing the resources of the head office in reality. Ireland should not have accepted the "unsubstantiated assumption" that the Apple IP licenses held by the relevant entities should be allocated outside of Ireland in circumstances where the reality of the situation is that there were no employees or personnel to conceivably carry out the functions assigned to the head offices based outside Ireland, and the Board minutes of the Head Office indicate the directors played an insufficient "active and critical role" in the control and management of the relevant Apple licenses. The use of operating expenses as the profit level indicator instead of sales in the case of ASI and total costs for AOE; the acceptance of a low rate of returns, as well as the comparables used in the analysis, were too challenged by the Commission. Finally, the Commission is of an opinion that in accepting the one-sided profit allocation method endorsed by the tax rulings endorsed State aid for Apple in breach of Article 107 of Treaty on the Functioning of the EU.

... and the arguments of Apple

Apple’s main arguments [Apple Sales International (“ASI”) and Apple Operations Europe (“AOE”), herein forth “Apple” or the applicant] are based on maintaining error in law by the European Commission in the interpretation of Irish tax law and EU State aid rules. At the outset, Apple claims that there is no legal requirement under Section 25 Taxes Consolidated Act (“TCA 1997”) that profit allocation to branches is compliant with the arm’s length principle (‘ALP’). Such a requirement does not exist under European law either, the applicant claims, adding that the ALP is not applicable standard of assessment under Article 107(1) TFEU, the relevant provision of EU law that prohibits unauthorised State aid. In relation to the development and commercial utilisation of Apple’s intellectual property rights (“IP”), Apple claims that the European Commission disregard the fact the Apple’s IP is developed, controlled and managed in California, United States, and not in Ireland. IP related profits should therefore be subject to tax in the United States. Apple further argues that the Commission failed to accept the branches in Ireland performed routine operations only and therefore were limited in its activates and commercial utilisation of IP. The applicant points to Commission’s alleged misunderstanding of the fact that the Irish branches did not play significant part in the critical profit making activities of the group. The applicant claims that the European Commission failed to establish ‘selectivity’, which is a decisive State aid criterion. Apple was treated by the Irish Revenue in the same way as the other non-resident entities for tax purposes, and the Commission wrongly assumed that Apple is an Irish resident entity for tax purposes. In respect of the transfer-pricing methodology involved, Apple claims that the Commission erred in law and fact by the choice and application of the Transactional Net Margin Method (“TNMM”). TNMM is a transfer pricing method that compares the net profit margin arising from a non-arm's length transaction with the net profit margins reached in similar arm's length transactions, and, then examines the net profit margin relative to an appropriate base such as costs, sales or assets. According to Apple, the subsidiary line of the Commission fails to articulate a correct profit attribution analysis. Finally, Apple claims that the European Commission breached the principles of legal certainty and non retroactivity by demanding recovery of the State aid, and that the European Commission decision exceeds Commission’s competence under Article 107(1) TFEU.



Case Law of the CJEU: Taxpayers’ Rights

08

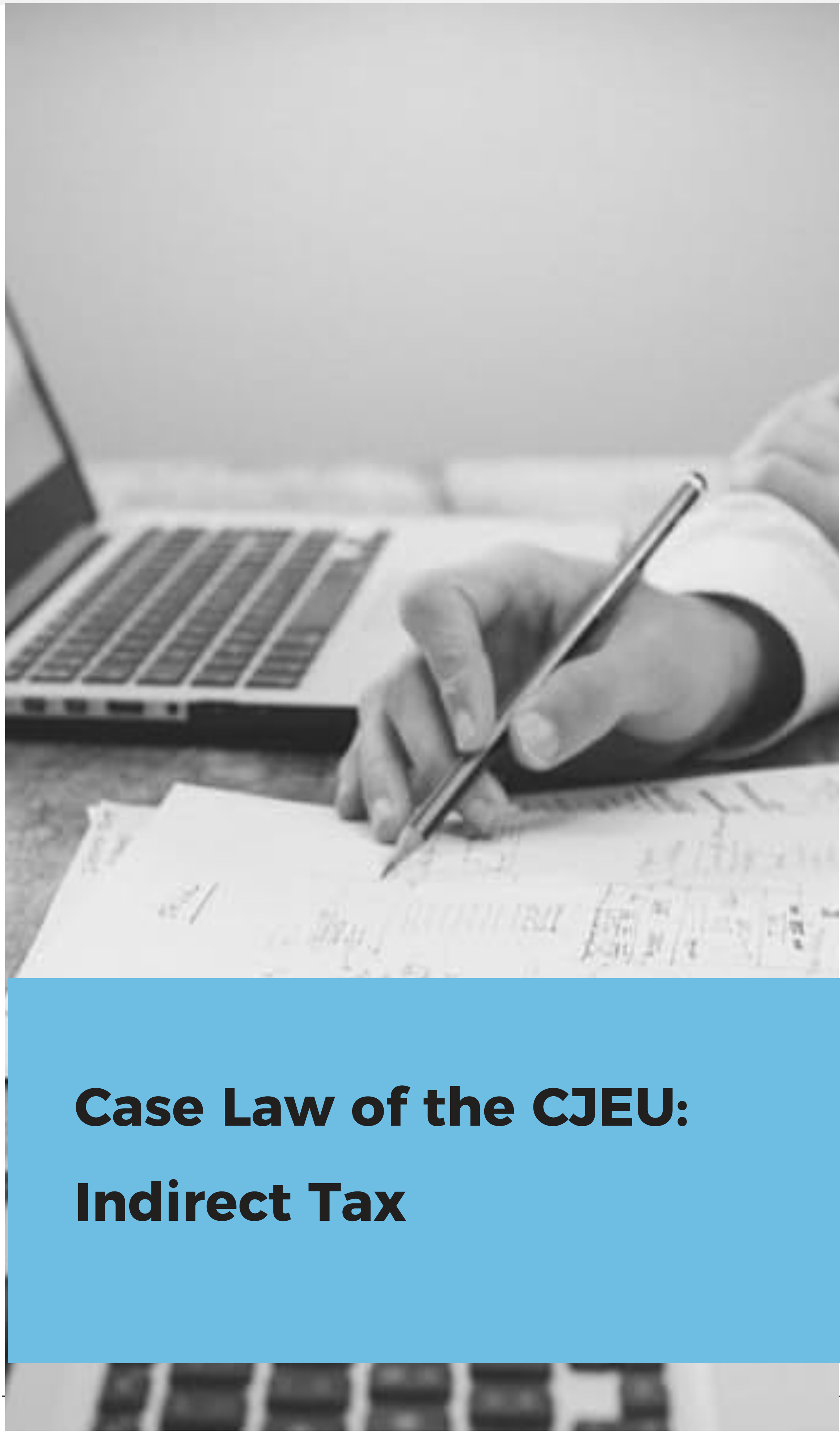
AG Wathelet's Opinion in C-682/15 *Berlioz*

The case C-682/15 Berlioz Investment Fund S.A., concerns the application of EU law in relation to administrative penalties for holders of information questioning the foreseeable relevance of information to be transferred to third countries (tax authorities' information exchange requests). Advocate General Wathelet in the Opinion issued on 10 January 2017 confirmed that the taxpayer has the right to challenge a request for information issued by a Member state's administration pursuant to Directive 2011/16, on request from a competent authority from another Member state.

Berlioz Investment SA was confronted with a request for information sent to Luxembourg by the French competent authority in relation to dividends received from Cofima, Luxembourg subsidiary of Berlioz. Berlioz had requested exemption from withholding taxes related to the inbound dividends received from Cofima, whilst the French tax authorities wanted to ascertain whether relevant conditions of French law have been fulfilled. The requested information from Luxembourg on behalf of the French authorities concerned in particular whether the company has place of effective management in Luxembourg, list of employees with link to company's registered office in Luxembourg, contractual relations between Berlioz and Cofima with any supporting documentation, information on shareholdings, amount of capital held by participants with percentage of capital held by each member etc.

Berlioz objected to providing the latter information based on it lacking 'foreseeable relevance'. As part of the domestic litigation in Luxembourg, Berlioz brought an appeal to the Administrative court in Luxembourg alleging breach of Article 6 of the European Convention on Human Rights and Fundamental Freedoms. The Administrative court filed a preliminary ruling to the Court of Justice of the EU bringing in by its own motion Article 47 of the EU Charter of Fundamental Rights, which is binding European Union law that guarantees the 'right of effective remedy and to a fair trial'. Advocate General Wathelet is of the opinion that the requested authority must be in a position to determine whether the requested information is foreseeably relevant, i.e. whether a nexus exists between the request for information and the factual situation of a particular taxpayer. There must be a possibility for judicial review of the legality of the information on which the fine was based, in order to comply with Article 47 of the Charter. This needs to be balanced with the legitimate objective of combating tax evasion and tax avoidance pursued by the Directive, so the deficiency must be manifest. This type of review according to the Advocate General complies with Article 47 of the Charter and the principle of proportionality.

The concept of foreseeable relevance, as a 'yardstick' to judge the legality of information requests, prevents tax authorities from 'fishing expeditions', i.e. making requests that have no apparent nexus to an open inquiry or tax investigation with a particular taxpayer. According to AG Wathelet, this approach is also supported by Article 26 OECD Model Tax Convention, by which this EU legislation was inspired. The Court of Justice was scheduled to deliver judgment in this case on 16 May 2017.



Case Law of the CJEU: Indirect Tax

09

Application of the Cost-sharing exemption to financial services

Much of the attention in the area of indirect tax case law has focused on the cost-sharing VAT exemption ("CSE") contained in Article 132(1) (f) of the Council Directive 2006/112/EC (the VAT Directive"). There are currently four cases pending before the ECJ concerning various aspects of the exemption and its applicability to the financial and insurance sectors.

AG Kokott issued two Opinions in March advocating a restrictive approach to the application of the CSE whereby it would not apply to the insurance sector or in cross-border situations. On the other hand, AG Wathelet issued an opposing view in April, opining that the exemption should apply to the banking and insurance sector.

If the CJEU follows the Opinions of Kokott it will have far-reaching implications for the financial services, and insurance sectors which would no longer be able to avail of the cost-sharing exemption.

One end of the spectrum:

AG Kokott's Opinion in C-605/15 *Aviva*

The Aviva case concerned the material scope of the exemption and whether it extended to insurance undertakings and in cross-border situations. The distortion of competition criterion was also examined. The case concerned the insurance group Aviva (the "Group") which operates in the fund management and insurance market throughout the EU. The group sought to establish a series of shared-service centres in 12 member states to supply the necessary services to the members of the Group. The services included H.R., I.T., Financial and accounting services. The Polish Administrative ourts on foot of a dispute between the Polish tax authorities and Aviva regarding the applicability of the CSE to the shared-service centres. Prior to establishing the shared-services centre in Poland, Aviva sought confirmation from the Polish tax authority that the Group members established in Poland would be able to avail of the CSE. The Polish tax authorities refused to confirm this position.

In response to the questions referred, AG Kokott focused on three points: whether a group of insurance companies falls within the material scope of the exemption; whether the exemption can apply to cross—border provision of services by members of the group to the members; and, how the "distortion of competition" criterion should be interpreted.

In answering these questions, AG Kokott concluded the following:

· The CSE does not apply to financial services. In reaching this conclusion much emphasis was placed on the schematic position; the exemption must be interpreted strictly as it is derived from the public interest exemptions rather than the general exemptions and therefore cannot not apply to financial services. This view differs significantly from that espoused by AG Wathelet in *Commission v Germany.*

· The CSE does not apply to the cross-border provision of services. Once again, she emphasised the need for a strict interpretation of exemptions concluding that the CSE should only apply within one territory. The application of the fundamental freedoms does not alter this conclusion, as any restriction can be justified by the need to provide fiscal supervision. She opined that if the CSE operated cross-border it would be "likely to jeopardise the principles of fiscal neutrality and legal certainty" and would make it very difficult for tax authorities to assess whether any distortions of competition are resulting. She also opined that Member States are obliged to ensure the effective and straightforward application of exemptions under the VAT Directive and if a single tax authority were obliged to evaluate the presence of any distortions of competition across the EU this would be impossible.

· Finally, in relation to the "distortion of competition" criterion, AG Kokott found that an implementing provision of national legislation will not be incompatible with EU law principles on the basis that it does not expand upon the list of criteria to be applied in assessing the distortion of competition. Nor will it be incompatible with principles of legal certainty, effectiveness and protection of legitimate expectations.

CFE has issued an Opinion Statement on the Opinion of AG Kokott.

AG Kokott's Opinion in C-326/15 *DNB Banka*

AG Kokott issued another Opinion on the subject in the *DNB Banka Case* (Case C-326/15)**.** The case concerned the DNB Banka AS, a member of the DNB Banka group, which operated in Latvia. It provided various financial services assumed to be exempt from VAT and received various administrative services from other members of the group. The dispute in question related to I.T. services provided by the Danish sister company and the transmission of costs to the ultimate Norwegian parent company. The question arose as to whether the services were exempt from VAT by virtue of the CSE.

The referral from the Latvian court asked whether:

· An independent group of persons within the meaning of the CSE requires the existence of separate legal entities or whether it includes groups of related undertakings whose companies provide each other services.

· The CSE applies to cross-border situation; and

· The CSE can apply when a cost- plus price has been imposed.

AG Kokott reiterated the emphasis on the strict interpretation of the exemption. The Following were her conclusions:

· The CSE may apply to services provided by the group as a unit but not to services supplied intra-group, as the supplies intra-group are not taxable services. She clarified that the CSE provider does not have to be a legal person, but must be taxable person acting in that capacity and a group of related companies does not satisfy this requirement.

· The CSE relates only to groups of taxable persons that provide services which are exempt from VAT by virtue of being listed in Article 132(1) of the VAT Directive (in the public interest); financial services undertakings do not fall within this category of services and therefore cannot avail of the CSE.

· Based on her reasoning in the *Aviva* case she also reiterated that the CSE could not operate cross-border.

· The CSE does not apply when a mark-up applies to the costs of the services (in this case a 5% mark-up). She reasons that Article 132(1)(f) of the VAT Directive states that the exemption applies only on the grounds that the members claim "*an exact reimbursement of their share of the joint expenses*" and the application of transfer pricing means it is not an exact reimbursement.

The other end of the spectrum:

Commission v Germany (Case C-616/15)

A different approach was adopted by AG Wathelet. He concluded that the CSE is not confined solely to activities carried out by independent groups of persons whose members operate in the public interest but that it may also apply to the financial services industry.

The case arose from infringement proceedings taken by the European Commission against German legislation, which confines the applicability of the CSE to specific groups of professionals, namely those providing hospital and medical care and assistance.

In reaching the conclusion that the CSE can extend to the financial services sector AG Wathelet placed less emphasis than AG Kokott on the legislative intent, and the position of the exemption in the VAT Directive, which he believed could be explained simply by bad drafting or through the legislative history. He held that neither the wording of the exemption nor the CJEU case law would indicate that the CSE must be limited to specific professions or exempt activities.

He opined that it is immaterial whether or not the service provider is a taxable person; the CSE does not stipulate a taxable status of the group but rather establishes a single requirement that the members of the group are carrying out an activity which is exempt from VAT or an activity for which they are not taxable persons.

He argues that the supply of services by independent groups of persons to their members is correctly to be considered transactions outside the scope of VAT rather than VAT exempt activities.

In his schematic interpretation of the legislation, he reasoned that the objective of the exemption is to ensure that VAT exempt entities should not have to pay VAT that they cannot subsequently deduct on the basis that they are VAT exempt. Due to this rationale, it must be concluded that the exemption should apply to all entities in groups that are exempt from VAT or are not taxable persons and not just those providing services in the public interest. Therefore, the exemption should apply to the financial and insurance industries.

CJEU Judgment in Commission v Luxembourg C-274/15

The ECJ has held that Luxembourg's implementation of the VAT exemption for supplies involving cost sharing groups (CSGs) and their members is incompatible with the VAT Directive.

The following aspects of the CSE in Luxembourg legislation have been found to be contrary to the VAT Directive:

· The CSE applies to services provided by an independent group to its members whose taxable activities amount to 30% of their annual turnover; it is not confined to independent groups whose members exclusively deal in VAT exempt activities. This has been found to be contrary to Article 2(1)(c) and Article 132(1)(f) of the VAT Directive.

· Members of the CSG can deduct from the VAT which there are liable to pay the VAT due or paid in respect of goods and services supplied to the CSG.

· When members of the CSG incur expenses in their own name but on behalf of the group and subsequently allocate those expenses to the CSG the legislation deems it outside the scope of VAT. This has been found to be contrary to Article 14(2)(c) and Article 28 of the VAT Directive.

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