

"Flip flap" in the application of the EU Participation Exemption Regime to Gibraltar Companies:

Luxembourg Tax Implications Clarified

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On 2 April 2020, in decision C-458/18 (the "Decision"), the Court of Justice of the European Union ("CJEU") ruled on the applicability of the Parent Subsidiary Directive 2011/96/EU ("PSD") to dividends paid by a company resident in the EU to a company resident in Gibraltar. This Decision could be seen as a "flip flop"⁽¹⁾ of the CJEU to a market practice set by the European Commission and the European Parliament (respectively the "Commission" and the "Parliament").

In that context, on 1 December 2020, in order to address the uncertainty resulting from the Decision and clarify its implications for Luxembourg corporate taxpayers, the Luxembourg tax authorities issued Circular L.I.R. n°147/2, 166/2 and Eval. N°63 ("Circular") related to the non-application of the PSD to companies incorporated in Gibraltar.

The importance of this Decision and the Circular for Luxembourg relies on the fact that, Luxembourg being a well-known and reputable investment holding jurisdiction, Luxembourg vehicles may be used to structure inbound and outbound shareholding investments through Gibraltar. This article presents (1) the Decision and (2) its impact for Luxembourg corporate taxpayers having holding activities in or from Gibraltar.

1. The Decision

a. Facts

From 2011 to 2016, GVC Services (Bulgaria) EOOD ("GVC Bulgaria"), a company incorporated and tax resident in Bulgaria, distributed dividends to its shareholder PGB Limited – Gibraltar ("PGB Gibraltar"), a company incorporated and tax resident in Gibraltar. GVC Bulgaria did not levy the Bulgarian withholding tax ("WHT") on the basis that PGB Gibraltar should benefit from the PSD as implemented by Bulgaria into its domestic tax legislation. However, the Bulgarian tax authorities did not share this position and denied the WHT exemption.

Therefore, GVC Bulgaria brought the case before the Administrative Court of Sofia, which lodged a request for a preliminary ruling to the CJEU on the following two questions:

- Should article 2(a)(i) and Annex I, part A, sub ab) of the PSD be interpreted as meaning that the expression "companies incorporated under the laws of the United Kingdom" also covers companies incorporated in Gibraltar?
- Should article 2(a)(iii) and Annex I, part B of the PSD be interpreted as meaning that the expression "corporation tax in the United Kingdom" also covers the corporation tax that has to be paid in Gibraltar?

b. Opinion of the Advocate General and Decision of the CJEU

In his opinion of 24 October 2019 ("Opinion"), the Advocate General ("AG") concluded that a company incorporated in Gibraltar and subject to corporate tax in Gibraltar should not benefit from the PSD. The Opinion was based on the grounds that when applying the fundamental principle of legal certainty, the legal forms and corporate taxes listed in Annex I, part A and part B of the PSD should be considered as exhaustive and should therefore not be extended to legal forms and corporate taxes not explicitly listed in this Annex.

In addition, although it was not in the scope of the request for a preliminary ruling, the AG analysed whether article 49 of the Treaty on the Functioning of the European Union ("TFEU") – related to the freedom of establishment – could apply to Gibraltar.

The AG recalled that following article 355-3 of the TFEU, Gibraltar is a Euro-



pean territory for whose external relations a Member State is responsible and to which the provisions of the Treaties apply. Gibraltar companies should therefore benefit from the freedom of establishment when such companies decide to incorporate subsidiaries in other Member States.

As a consequence, the law of a Member State (e.g. Bulgaria) which applies a WHT on dividends paid to all types of companies incorporated in Gibraltar, without reference to the material scope of the PSD or any other reason likely to distinguish them from comparable companies established in other Member States, but for the sole reason of being established in that territory, should be considered as a discriminatory restriction to the freedom of establishment precluded by Article 49 TFEU.

As a consequence, the refusal to exempt from WHT dividends paid by subsidiaries established in a Member State to their parent companies incorporated in Gibraltar in a general way can only be the result of the application of an anti-abuse measure to an individual situation.

In its Decision, the CJEU followed the Opinion of the AG on the point that the PSD does not cover Gibraltar companies. However, since the question of the compatibility of the PSD - as implemented into Bulgarian law - with the freedom of establishment was not included in the request for a preliminary ruling, the CJEU did not address this point as suggested by the AG.

2. Analysis of the Decision

a. A decision against a market practice set by the Commission and the Parliament

In the past, some Member States have expressed some doubts about the application of the PSD, Directive 2009/133/EC on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares and Directive 2003/49/EC on the common system of taxation applicable to interest and royalty payments ("Tax Directives") to Gibraltar companies due to the relationship existing between Gibraltar and the United Kingdom and to the omission of an explicit inclusion (or exclusion) of Gibraltar in the Tax Directives.

In this context, in 2005, the Commission addressed to the government of Gibraltar a written (but non-public) confirmation that the three Tax Directives were applicable in full to Gibraltar.

On 30 November 2016, following a petition sent to the Parliament, the Commission replied that, like any other piece of secondary legislation, the Tax Directives apply in full to Gibraltar.

b. The Luxembourg tax consequences of the Decision

(i) In the Decision, the CJEU excluded companies incorporated in Gibraltar from the benefit of the PSD.

In practice, it means that dividends received and capital gains realised by a Luxembourg company ("LuxCo") on a qualifying participation in a Gibraltar company ("GibCo") should not be exempt from corporate income tax ("CIT")

and municipal business tax ("MBT") under the provisions implementing the PSD into Luxembourg law (i.e. Article 166-2 n°1 of the Luxembourg income tax law "LITL"). In addition, a participation held by a LuxCo in a GibCo should not benefit from the net wealth tax ("NWT") exemption applicable to participations held in EU companies within the meaning of the PSD (i.e. Paragraph 60-2 n°1 of the Luxembourg evaluation law "BewG").

For the same reason, dividends distributed by a LuxCo to a GibCo (i.e. where GibCo holds a qualifying participation in LuxCo) should not be exempt from Luxembourg WHT under the provisions implementing the PSD into Luxembourg law (i.e. article 147-2-a of the LITL).

(ii) As an administrative tolerance in order to take into account the concerns of taxpayers who legitimately relied on the approach taken by the Commission and the Parliament prior to the Decision, the Luxembourg tax authorities clarified in the Circular that the Decision will not have any retroactive effect and will only apply as from 1 January 2021.

In particular, the Luxembourg tax authorities provided the following guidance:

- Dividends received and capital gains realised until 31 December 2020 by a LuxCo from its participation in a GibCo should continue to benefit from the PSD as implemented into Luxembourg law (i.e. Article 166-2 n°1 of the LITL). Such dividends and gains will therefore not be subject to CIT and MBT if all the other applicable conditions are met (e.g. holding period and shareholding threshold) as at 31 December 2020.

- Dividends distributed by a LuxCo to a GibCo until 31 December 2020 should continue to benefit from the Luxembourg provisions implementing the PSD (i.e. article 147-2-a of the LITL) until 31 December 2020. Such distribution will therefore not be subject to WHT if all the other applicable conditions are met (e.g. holding period and shareholding threshold).

In practice, it means that the Decision will not have any negative CIT, MBT and WHT effect on dividend distributions and capital gains realised until 31 December 2020. However, as from 1 January 2021, the PSD provisions implemented into the LITL will no longer apply to Gibraltar resident companies. In the same way, the shares held by a LuxCo in a GibCo as at 1 January 2021 will no longer be exempt from NWT under the provisions of the Luxembourg law referring to Companies within the meaning of the PSD (i.e. Paragraph 60-2 n°1 of the BewG).

Despite the non-application of the Luxembourg provisions implementing the PSD as from 1 January 2021, the Circular confirms that the other provisions of the Luxembourg participation exemption regime (i.e. the provisions regarding the CIT, MBT and NWT exemption applicable under certain conditions to non-resident companies other than the ones within the meaning of the PSD) will continue to apply if GibCo is a fully taxable company subject to income tax at a rate comparable to the Luxembourg CIT (a minimum income tax of 8.5% generally satisfies this requirement), levied on a basis similar to the Luxembourg one (which could be the case in certain circumstances).

As far as dividend distributions from a LuxCo to a GibCo are concerned, these will no longer benefit from any WHT exemption since the exemption of dividends arising from non-resident fully taxable companies only applies to those companies tax resident in a country with which Luxembourg has signed a double tax treaty (and Luxembourg does not have a double tax treaty with Gibraltar).

(iii) Potential impact of the extension of the Decision outcome.

The key outcome of the Decision is that the CJEU confirms its literal reading of the list provided in Annex I, part A and part B of the PSD. Hence, one may expect that the CJEU would confirm such literal reading when applying the provisions of the Tax Directives, such as the Directive 2009/133/EC on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares, and the Directive 2003/49/EC on the common system of taxation applicable to interest and royalty payments. As far as the EU Directive 2003/49/EC is concerned, the Decision will have no adverse tax consequences in Luxembourg since arm's length interest and royalty payments are not subject to WHT in Luxembourg based on Luxembourg internal rules.

Article 3 of Directive 2009/133/EC (mergers, divisions, partial divisions, transfers of assets and exchanges of shares) states that the benefits of the Directive should be limited to companies of a Member State (i) whose legal form is listed in Annex I, part A and (ii) which are subject to one of the corporation taxes listed in Annex I, part B of the Directive. Hence, it is expected that the reasoning of the CJEU regarding the applicability of the PSD should also apply to Directive 2009/133/EC. In practice, it would mean that in certain cases restructuring transactions, such as mergers, divisions, partial divisions, transfers of assets and exchanges of shares, involving a company incorporated in Gibraltar may trigger the taxation of latent capital gains in Luxembourg.

Lastly, based on the rules regarding the determination of the tax residence of a company in the case of conflict of residence, one may encounter situations in which a company is incorporated in a

third country but is subject to corporate tax in an EU Member State, as its place of effective management is situated therein. Based on the Decision and the conclusions of the AG, it is expected that the PSD would also not apply in such case, since one of the two cumulative conditions of the PSD (i.e. incorporation in an EU Member State) would not be met.

Conclusion

The CJEU considers that the PSD should not apply to Gibraltar since this territory of the United Kingdom is not specifically listed in Annex I, part A and B of the PSD.

The Circular clarifies that the Decision will not have any retroactive effect and will only apply as from 1 January 2021. In addition, the Circular confirms that the other provisions of the Luxembourg participation exemption regime (i.e. the provisions regarding the CIT, MBT and NWT exemption applicable under certain conditions to non-resident companies other than the ones within the meaning of the PSD) will continue to apply to Gibraltar Companies, to the extent that they are fully taxable and subject to income tax at a rate comparable to the Luxembourg CIT.

In the context of Brexit, and especially once it becomes effective, it will also be important to monitor how the concept of freedom of establishment (which Gibraltar is entitled to based on article 355-3 of the TFEU) will further apply to the United Kingdom and Gibraltar. As usual in tax matters, there is no one-fit-all approach and a careful tailor-made review of any envisaged transactions should be considered before engaging into any corporate implementation steps in order to avoid unnecessary costs and wasting time.

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1) In football the "flip flop" is a well-known dribbling move.

TABLEAU DE BORD AGEFI Luxembourg	30-Nov-2020	31-Dec-2019	DIFF %	
Dow 30 (DJII)	29,638.64	28,538.44	3.86%	
S&P 500 (GSPC)	3,621.63	3,230.78	12.10%	
Euro Stoxx 50	3,492.54	3,748.47	-6.83%	
DAX (GDAXI)	13,291.16	13,249.01	0.32%	
CAC 40 (FCHI)	5,518.55	5,978.06	-7.69%	
Lux General Index	591.62	647.53	-8.63%	
FTSE 100 (FTSE)	6,298.44	7,542.40	-16.49%	
Nikkei 225 (N225)	26,433.62	23,656.62	11.74%	
Shanghai (SHCOMP)	3,418.16	3,050.12	12.07%	
US Fed Funds Rate	0.09%	1.75%	-1.66%	
3 Month US Treasury Rate	0.08%	1.55%	-1.47%	
5 Year US Treasury Rate	0.37%	1.69%	-1.32%	
Banque centrale européenne (BCE), taux refi	0.00%	0.00%	0.00%	
Euro LIBOR 3 mois	-0.55%	-0.41%	-0.14%	
Eurozone obligations d'Etat 5 ans	-0.52%	-0.11%	-0.41%	
Pétrole brut (coût de production) : 1 litre=	0.2382	0.3423	-30.40%	€ West Texas Intermediate (prix en euro par litre)
Gaz naturel : 1 m3=	0.0851	0.0691	23.26%	€ Natural Gas, Henry Hub-I (prix en euro par m3)
Gaz naturel : 1 MWh=	8.2110	6.6617	23.26%	€ Natural Gas, Henry Hub-I (prix en euro par MWh)
Gaz naturel : 1 MMbtu=	2.8800	2.1900	31.51%	\$ Natural Gas, Henry Hub-I (prix en \$ par MMbtu)
Or : 1 Kg=	47,735.44	43,541.05	9.63%	€
Or : 1 oz=	1,777.38	1,519.50	16.97%	\$
Argent : 1 Kg=	607.24	510.92	18.85%	€
Argent : 1 oz=	22.61	17.83	26.81%	\$
E1=	1.1971	1.1220	6.69%	\$ - le dollar augmente par rapport à l'euro
\$1=	33.70	35.95	-6.27%	LUF/B EF Francs luxembourgeois/belges
£1=	5.48	5.85	-6.27%	FRF Francs français
DEM=	1.63	1.74	-6.27%	DEM Deutsche Marks
NLG=	1.84	1.96	-6.27%	NLG Gulden (florins)

Ce tableau de bord, une exclusivité d'AGEFI Luxembourg, permet au lecteur :

1^{er} de voir les retours des principaux actifs et indices financiers pour l'année en cours

2^{de} de voir sur une page les principaux indices boursiers et taux d'intérêt

3^{de} de connaître le coût de production de plusieurs produits d'énergie en euro, à comparer avec le prix au détail

4^{de} de connaître le prix de l'or et de l'argent en kilo et en euros

5^{de} de convertir le dollar dans son ancienne devise