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ATOZ REPORTS

EXTENDED ANALYSIS ON CURRENT TAX TOPICS - NOVEMBER 2020

Non-application of the Parent Subsidiary Directive to companies incorporated in Gibraltar: Consequences for Luxembourg

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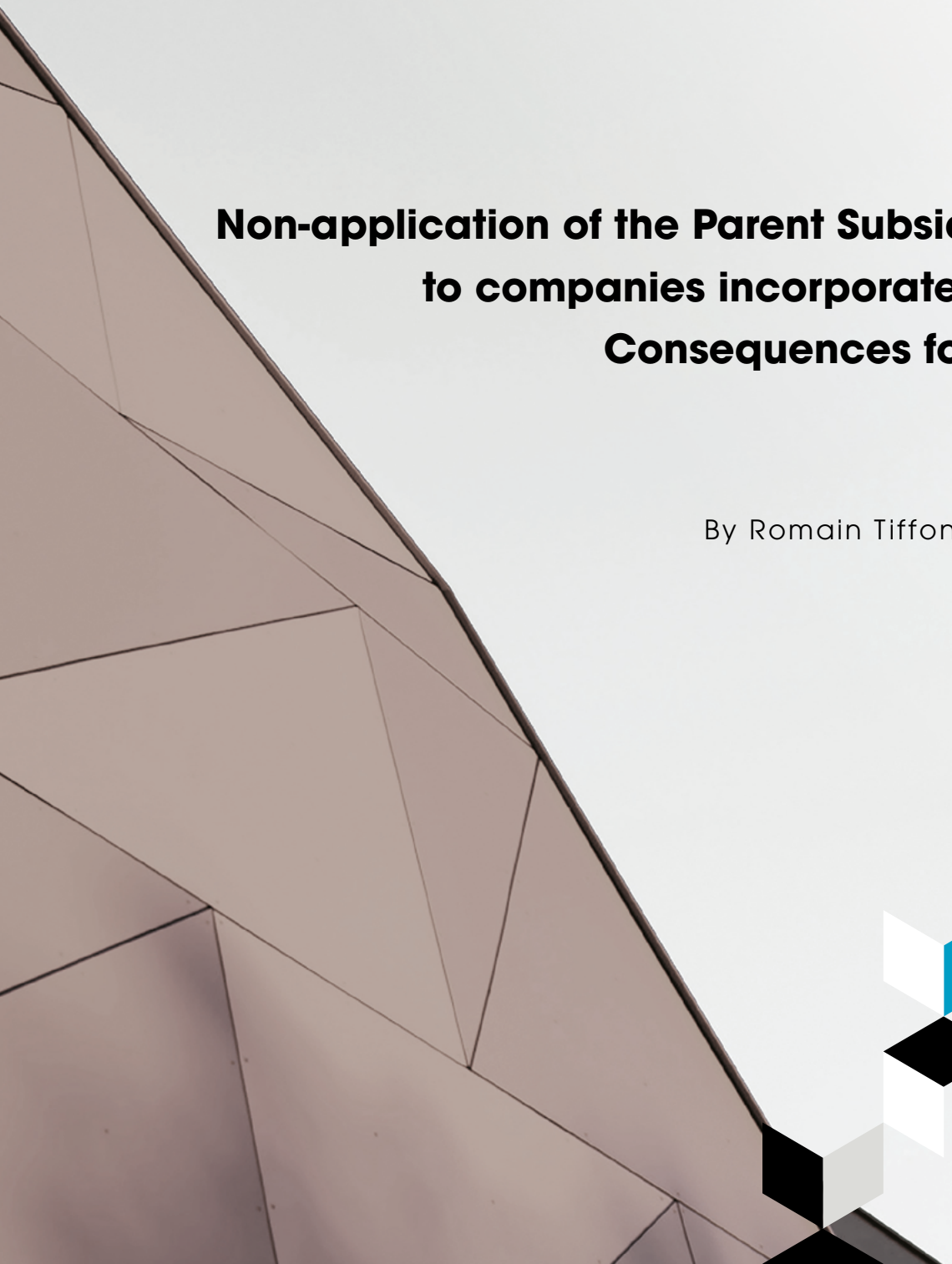

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01 INTRODUCTION

On 2 April 2020, the Court of Justice of the European Union ("**CJEU**") rendered a decision ("**Decision**") in case C-458/18, ("**GVC Services**") in response to a request for a preliminary ruling submitted by the Administrative Court of Sofia (Bulgaria) regarding the applicability of the Parent Subsidiary Directive 2011/96/EU (**PSD**)[1] in order to exempt from withholding tax ("**WHT**") dividends paid by a company resident in the European Union (the "**UE**" - Bulgaria in the case hand) to a company resident in Gibraltar. This Decision could be seen as a "flip flap" of the CJEU to the well-established market practice set by the European Commission and the European Parliament (respectively the "**Commission**", and the "**Parliament**") of the EU.

In the case at hand, the CJEU ruled that a company incorporated and subject to corporation tax in Gibraltar should not be assimilated to "a company incorporated under the law of the United Kingdom and subject to corporation tax in the United Kingdom", as listed in the annex I, part A and part B of the PSD. Therefore, the WHT exemption on dividends paid by a company resident in the EU to a company resident in Gibraltar could not be based on the provisions of the PSD.

The importance of that Decision 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 ATOZ Reports aims at (i) describing the facts and conclusions of the CJEU and (ii) analysing why this decision goes against a current market practice set by the Commission and the Parliament and what could be the concrete impacts for Luxembourg corporate taxpayers performing holding activities.

02 DESCRIPTION OF THE DECISION

2.1. Facts

GVC Holdings PLC ("**GVC**"), a limited company incorporated in the Isle of Man and listed on the London Stock Exchange[2], is the parent-holding company of one of the world's largest sports betting and gaming groups which owns notably Bwin, Crystalbet and Ladbrokes. The online business of GVC is headquartered in Gibraltar[3] and PGB Limited – Gibraltar ("**PGB Gibraltar**") is a Gibraltar intermediate holding company of GVC[4].

From 13 July 2011 to 21 April 2016, GVC Services (Bulgaria) EOOD ("**GVC Bulgaria**"), a company incorporated and tax resident in Bulgaria[5] and held by PGB Gibraltar, distributed dividends to PGB Gibraltar without levying the Bulgarian WHT. GVC Bulgaria considered that PGB Gibraltar should be treated as an entity having its fiscal domicile in the EU[6], and as such would be entitled to benefit from the PSD as implemented by Bulgaria into its domestic tax legislation.

On 1, 7 and 22 December 2017, the Sofia tax office denied the application of the WHT exemption on the dividend so distributed and notified GVC Bulgaria of a tax adjustment in an amount of BGN 930,529.54[7] (i.e. principal of BGN 669,690.32 and interest for late payment of BGN 260,839.22). On 19 February 2018, following the challenge of the tax adjustment by GVC Bulgaria, the director of the Sofia tax office confirmed the non-application of the Bulgarian WHT exemption on the dividend distributed by the company to PGB Gibraltar. The Bulgarian company then brought the case before the Administrative Court of Sofia.

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1 The PSD 90/435/CEE of 23 July 1990 was recast by the PSD 2011/96/EU of 30 November 2011 which was itself amended by the PSD 2015/121 of 27 January 2015.

2 See Symbol: GVC, Name: GVC Holdings PLC Ord EUR0.01.

3 See the GVC 2019 annual report and accounts (page 63/190).

4 See GVC "Notification of Transfer to a Premium Listing" page 178/193: https://gvc-plc.com/wp-content/uploads/2017/12/Premium_Listing.pdf.

5 GVC Bulgaria is a unipersonal limited liability company - see point 5 of the "Request for a preliminary ruling" dated 12 July 2018.

6 See point 6 of the "Request for a preliminary ruling".

7 EUR 475,779.75 using the BGN/EUR BCE exchange rate of 0,5113.

Although Gibraltar is not part of the United Kingdom, GVC Bulgaria argued that Gibraltar, whose foreign relationship is assumed by the United Kingdom[8], should be considered as part of the territory of the EU[9] and should therefore be eligible to benefit from EU legislation[10][11]. Indeed, Gibraltar was the only dependent territory of the United Kingdom that joined the EU as part of the Treaty of Accession in 1972 which defined notably the conditions of entry of the United Kingdom into the EU. The Treaty of Accession of 1972 excluded Gibraltar from certain areas such as the EU Customs Union and the Common Agricultural Policy but did not mention the exclusion of the legislation related to dividend distributions. Hence, GVC Bulgaria considered that PGB Gibraltar fulfilled the conditions of the PSD since PGB Gibraltar (i) is assimilated to a company incorporated in the United Kingdom and (ii) is subject to a corporation tax in Gibraltar corresponding to the corporation tax in the United Kingdom. Therefore, dividends distributed by GVC Bulgaria should be exempt from Bulgarian WHT based on the application of the PSD.

The director of the Sofia tax office considered that the list of companies based on their country of incorporation and legal form and the list of corporate taxes included in the PSD had to be considered as exhaustive and could therefore not be extended to other countries and taxes not included in these two lists[12]. In this context, Gibraltar not being listed as a country of incorporation and the Gibraltar corporation tax not being listed as an eligible corporation tax, the director of the Sofia tax office concluded that PGB Gibraltar should not benefit from the Bulgarian WHT exemption based on the PSD. Hence, dividends distributed by GVC Bulgaria to PGB Gibraltar should be subject to WHT in Bulgaria[13].

On 12 July 2018, the Administrative Court of Sofia lodged a request for a preliminary ruling to the CJEU on the two following questions[14]:

- 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?

The CJEU already addressed requests for preliminary rulings regarding the application of the EU legislation to Gibraltar[15]. However, it is the first time that the CJEU has addressed a request for a preliminary ruling on the application of the PSD to Gibraltar.

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

In a first stage, in his opinion delivered on 24 October 2019 ("**Opinion**"), the Advocate General analysed whether (i) the PSD is applicable to Gibraltar and if so, (ii) whether the PSD should apply to companies incorporated in Gibraltar.

The Advocate General considered that the PSD is applicable to Gibraltar, based on the grounds that the EU legislation is applicable to the European territories (e.g. Gibraltar) for whose external relations a Member State ("**Member State**" - i.e. the United Kingdom) is responsible[16]. In that context, the Advocate General (i) recalled the status of Gibraltar regarding the United Kingdom[17], (ii) mentioned that this country is included in the list of the non-self-governing territories of the Charter of the United Nations on the declaration regarding non-self-governing territories[18] and (iii) specified that the PSD is not included in the list of EU areas for which Gibraltar has been excluded, such as the EU Customs Union and Common Agricultural Policy.

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8 The Gibraltar Constitution Order of 14 December 2006 states that "the United Kingdom remains fully responsible for Gibraltar's external relations". See www.gibraltarlaws.gov.gi/papers/gibraltar-constitution-order-2006-6.

9 Since 2004, the citizens of Gibraltar have participated in elections for the Parliament as part of the South West England constituency. On 23 June 2016, Gibraltar voted along with the United Kingdom in the Brexit referendum - see www.gibraltar.gov.gi/brexit.

10 Under the treaty of Utrecht signed between Spain and the United Kingdom on 13 July 1713 – in order to end the War of the Spanish Succession – Gibraltar was ceded to the United Kingdom. Since then, Gibraltar is a British Overseas Territory. The head of the State of Gibraltar is the British monarch (Queen Elizabeth II) who is represented by the Governor of Gibraltar. The Governor enacts day-to-day matters on the advice of the Gibraltar Parliament. The Governor of Gibraltar (i.e. Nick Pyle Obe) is responsible for the British government in respect of defence, foreign policy, internal security and certain functions in relation to public offices. See www.gov.uk/world/gibraltar/news.

11 Article 355-3 of the Treaty on the Functioning of the European Union ("**TFEU**") states that "the provisions of the Treaties shall apply to the European territories whose external relations a Member State is responsible".

12 Annex I, part A to the PSD lists the eligible companies (legal form and place of incorporation) while Annex I, part B lists the eligible corporation taxes.

13 See article 194 of the Bulgarian corporate tax law – see point 11 of the "Request for a preliminary ruling".

14 See www.curia.europa.eu, documents "Request for a preliminary ruling" and "C-458/18 – Application (OJ)" dated 7 September 2018.

15 See C-267/16 regarding the customs territory of the EU, and C-591/15 regarding the freedom to provide services.

16 See footnote 12.

17 See footnote 11.

18 See Chapter XI, article 73 of the Charter of the United Nations and the said list on www.un.org/fr/events/nonselfgoverning/nonselfgoverning.shtml.

However, the Advocate General pointed out that the PSD is not applicable to companies incorporated in Gibraltar, on the grounds that when applying the fundamental principle of legal certainty, the legal forms listed in Annex I, part A of the PSD should be considered as exhaustive and should therefore not be extended to legal forms not explicitly listed in this Annex. Hence, the expression "companies incorporated under the law of the United Kingdom" should not cover companies incorporated in Gibraltar[19]. In the case at hand, the Advocate General considered that a theological, extensive interpretation of the PSD would not make sense since the strict reading of the provision of annex I, part A of the PSD clearly reflects the intention of the legislator[20] and hence would not result in an absurd or non-understandable situation.

For the same reason of legal certainty, the Advocate General also considered that the term "corporation tax in the United Kingdom" should not cover the corporation tax which has to be paid in Gibraltar[21].

As a result, the Advocate General concluded that a company incorporated in Gibraltar and subject to corporate tax in Gibraltar should not benefit from the PSD[22]. Concretely, it means that dividends distributed by GVC Bulgaria to PGB Gibraltar cannot be exempt from Bulgarian WHT based on the provisions of article 194 of the Bulgarian corporate tax law implementing the PSD into Bulgarian legislation.

In a second stage, although it was not in the scope of the request for a preliminary ruling, the Advocate General analysed whether article 49[23] of the TFEU – related to the freedom of establishment[24] – could apply to a parent company incorporated in Gibraltar (i.e. PGB Gibraltar).

In that context, the Advocate General recalled that since Gibraltar is a European territory for whose external relations a Member State is responsible, the provisions of the European treaties are to apply to Gibraltar pursuant to Article 355(3) TFEU. 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 Advocate General concluded that the law of an EU Member State (i.e. Bulgaria) which applies a WHT on dividends paid to all types of companies incorporated in Gibraltar without reference to the material scope of Directive 2011/96 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.

This restriction can only be considered as compatible with EU law to the extent that such restriction (i) is justified on the grounds of public policy, public security or public health and (ii) satisfies the conditions laid down in the CJEU case-law as regards their proportionality.

The Bulgarian government indicated that the purpose of the general Bulgarian WHT provision (i.e. article 194 of the Bulgarian corporate tax law) denying the WHT exemption on dividends distributed to companies incorporated in Gibraltar is to fight against tax fraud and tax evasion and preserve a balanced distribution of taxing power between Member States (i.e. in the case where a Bulgarian taxpayer interposes a company incorporated in Gibraltar in order to receive and not declare dividends distributed by a Bulgarian company).

However, the Advocate General indicated that it results from a constant jurisprudence of the CJEU that a legislation restricting the freedom of establishment in order to fight against tax fraud and tax evasion and preserving balanced distribution of taxing power between Member States, could only be justified if it targets wholly artificial arrangements[25]. In addition, these objectives (i.e. fighting tax fraud and tax evasion, preserving tax balance between Member States) do not correspond to the notion of public policy as defined by the CJEU case law[26]. Furthermore, the general application of the provision of article 194 of the Bulgarian corporate tax law should not be seen as proportionate to the objectives indicated by the Bulgarian government since such exclusion from the Bulgarian WHT exemption regime is only justified on the grounds of the country of residence of the parent company (i.e. Gibraltar), and not on specific anti-abuse rules.

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19 See point 36 of the Conclusions.

20 See C-247/08.

21 See point 41 of the Conclusions.

22 See point 43 of the Conclusions.

23 "Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.".

24 The CJEU applies the freedom of establishment – instead of the freedom of movement of capital as per article 63 of the TFEU – in the case where an entity holds a significant power of influence in another entity. In the case at hand PGB Gibraltar held a participation of 100% in GVC Bulgaria, which is deemed to significant power of influence.

25 See C196/04 - Cadbury Schweppes Overseas.

26 See point 58 of the Conclusions.

Finally, the Advocate General stated that Gibraltar is part of numerous treaties and multilateral conventions on administrative cooperation in tax matters that should allow Member States to request and obtain information from Gibraltar in the case of a tax audit[27].

As a conclusion, after confirming that the freedom of establishment is applicable to Gibraltar, the Advocate General concluded that 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, as has apparently been the case in the present case, is precluded by Articles 49 and 52 TFEU. Such a refusal can only be the result of the application of an anti-abuse measure to an individual situation[28].

In the decision of 2 April 2020, the CJEU follows the conclusions of the Advocate General and states that for reason of legal certainty (i) the term "companies incorporated under the law of the United Kingdom" does not cover companies incorporated in Gibraltar and (ii) the term "corporation tax in the United Kingdom" should not cover the corporation tax that has to be paid in Gibraltar[29]. The CJEU also refers to the written observations of the United Kingdom where it was mentioned that, under United Kingdom law, a company incorporated and subject to corporate tax in Gibraltar should not be considered as a company incorporated and subject to corporate tax in the United Kingdom[30].

However, as it was not requested in the request for a preliminary ruling lodged by the Administrative Court of Sofia, the CJEU did not analyse the compatibility of Article 194 with the freedom of establishment, as suggested by the Advocate General.

03 ANALYSIS OF THE DECISION

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

The question of the applicability of the PSD, and also of Directive 2009/133/EC on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares[31] and Directive 2003/49/EC on the common system of taxation applicable to interest and royalty payments ("**Tax Directives**"), has been raised several times in the past, 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 the past, some Member States have expressed some doubts about the application of the Tax Directives to Gibraltar and Gibraltar companies. In that 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 31 August 2016, a representative of a company incorporated in Gibraltar sent a petition to the Parliament on the application of the PSD to a Gibraltar limited company subject to tax in Gibraltar. The company was a shareholder of a Belgian limited liability company[32]. The petitioner argued that the PSD contains an omission. He also established that companies subject to Gibraltar law are not included in the list in Annex 1, part A of the PSD and that the Gibraltar Income Tax is not included in the list in Annex 1, part B of the PSD either. The petitioner wondered whether the fact that (due to this omission) the PSD can never be applied to Gibraltar companies constitutes a conflict with EU law.

On 30 November 2016, the Commission replied that following Article 355-3 of the TFEU, Gibraltar falls within the territorial scope of the EU, since it is a European territory for whose external relations the United Kingdom is responsible. As a consequence, any secondary legislation based on the treaty applies in full to Gibraltar. The failure to mention Gibraltar specifically in the Directive was considered as of no importance once it is accepted that the obligations created by the PSD apply to the whole territory of the EU.

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27 See point 63 of the Conclusions.

28 See point 66 of the Conclusions.

29 See point 35 of the Decision.

30 See points 38 and 39 of the Decision.

31 The Directive 2009/133/EC of 19 October 2009 replaced the Directive 90/434/EC of 23 July 1990.

32 See www.europarl.europa.eu/doceo/document/PETI-CM-595531_EN.pdf?redirect.

The Commission services concluded that the PSD, like any other piece of secondary legislation in the area of direct taxation, does apply in Gibraltar.

3.2. Luxembourg tax consequences of the Decision

In order to analyse the concrete corporate tax consequences[33] of the Decision in Luxembourg, it is worthwhile reminding the relevant provisions implementing the PSD and more generally the Luxembourg participation and WHT exemption regime into Luxembourg law[34] for (i) inbound and (ii) outbound dividends. One should then be able (i) to determine the impact of the existence (or lack thereof) of an advance tax agreement covering past, current or future investments and (ii) to point out the potential consequences of the extension of the Decision to restructuring transactions such as mergers, demergers and contributions, and situations where a company would be incorporated in a third party country while being fully subject to a corporation tax listed in Annex I, part B of the PSD.

As a preliminary comment, based on the conclusions of the Advocate General on the applicability of Article 194 of the Bulgarian corporate tax law[35], it is important to note that the Luxembourg provisions implementing the PSD (i.e. articles 166 and 147 of the Luxembourg income tax law "**LITL**" – see below point i. and ii.) should be considered in line with the CJEU case law on the freedom of establishment. Indeed, the restrictions imposed by these provisions should be considered as proportional as they are not general and allow dividends distributed by/to foreign subsidiaries which are comparable to Luxembourg companies to benefit from the same exemption at the level of the Luxembourg parent/subsidiary company, unless an abuse of law is characterised.

(i) From a pure technical perspective and on a case by case basis, it should be possible for a Luxembourg company to benefit from the Luxembourg participation exemption regime for inbound distributions and gains on participations in Gibraltar companies.

Indeed in application of article 166 (2)-3 LITL, considering that based on the Decision the PSD should not be applicable to Gibraltar[36], dividends paid by a company incorporated and subject to corporate tax in Gibraltar to its Luxembourg parent company[37] would be exempt from Luxembourg corporate income taxation if the Gibraltar company is a fully taxable company that is subject to income tax at a rate comparable to the Luxembourg corporate income tax, levied on a basis similar to the Luxembourg one. In addition, as of 2016, the benefit from the exemption is subject to an anti-hybrid exception and to the general anti-abuse rule ("**GAAR**")[38].

Hence, one of the key conditions to determine whether or not income arising from a company incorporated and subject to tax in Gibraltar may benefit from the Luxembourg participation exemption regime (for corporate income tax and municipal business tax), a comparability test should be carried out in Luxembourg (in principle every year) to determine if the Gibraltar company is subject to a comparable corporate income tax rate. According to the Luxembourg parliamentary documents[39], a foreign corporate income tax rate equivalent to the Luxembourg corporate income tax rate needs to fulfil the following conditions:

- The corporate income tax is levied by the tax authorities in an obligatory manner.
- The effective tax rate cannot be lower than half of the Luxembourg aggregate income tax rate (i.e. as of 2019, a minimum income tax of 8.5% generally satisfies this requirement).
- The corporate income tax rate is applied on a taxable basis comparable to the Luxembourg corporate income tax base.

Gibraltar certainly levies corporate income tax compulsorily on the income of its resident corporate taxpayers and the corporate tax is generally levied at a rate of 10%[40]. However, the taxable income of a Gibraltar company is determined based on the principle of territoriality[41]. In that respect, only income derived from Gibraltar or received in Gibraltar from outside Gibraltar should be subject to tax. Therefore, Gibraltar does not levy corporate income tax on a similar basis to Luxembourg (i.e. worldwide basis).

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33 Non exhaustive list.

34 The conditions related to the size of the participation and the minimum holding period will not be addressed.

35 See point 66 of the Conclusions.

36 See point 42 of the Decision.

37 SOPARFI fully subject to Luxembourg corporate income tax and municipal business tax.

38 See article 166 (2bis) of the LITL. The provision is only applicable for dividends paid by a qualifying company resident in a Member State.

39 See Parliamentary document n°5232 of the law of 9 July 2004 modifying article 166 of the LITL.

40 The 10% corporate tax rate should be fine for the purpose of the Luxembourg comparability test as from the year 2018 onwards since before 2018, the Luxembourg minimum comparable corporate income tax rate was 10.5%.

41 See the IBFD tax report on Gibraltar (last reviewed on 15 January 2020).

Nevertheless, it is worth noting that it has been mentioned in the parliamentary documents on the tax treaty between Luxembourg and Hong Kong, that the benefit of Article 166 LITL and of the Grand-Ducal Regulation of 21 December 2001[42] cannot be denied on the grounds that a person is subject to tax under the principle of territoriality. Although there is no tax treaty between Luxembourg and Gibraltar, this aspect shows, in the view of the author, that one should not take a too formalistic approach regarding the territoriality versus the worldwide basis criteria and shall therefore not prevent a Gibraltar company from demonstrating that, on a yearly basis, it would have been taxable at a rate corresponding to at least 8.5% on the same basis, if this company were subject to corporate income tax in Luxembourg.

Based on the conclusions of the Advocate General, it is key that provisions restricting the freedom of establishment are proportionate and allow a comparable entity of a European territory to benefit from the same exemption, unless there is an abuse of law. In the context of Brexit, and especially once it will become effective, it will be important to monitor how the concept of freedom of establishment (which Gibraltar is entitled to based on Article 355-3 of the TFEU)[43] will still apply to the United Kingdom and Gibraltar.

If the comparability test is not met, dividends and capital gains realised by the Luxembourg parent company on its shareholding in the Gibraltar company should be subject to corporate income tax and municipal business tax at a rate ranging from 22.80% to 24.94% (depending on whether the taxable base of the Luxembourg company is below or above EUR 175,000, assuming that the company has its legal seat in Luxembourg city). Finally, the fair market value of such shareholding should be subject to net wealth tax at a rate of 0.5% (for unitary value below EUR 500mio) and 0.05% (for the part of the unitary value exceeding EUR 500mio).

(ii) From a pure technical perspective and on a case by case basis, it cannot be excluded that a Luxembourg company may benefit from the Luxembourg WHT exemption regime on dividend distributions to Gibraltar parent companies.

Indeed, in application of article 147-2 e) LITL, considering that based on the Decision the PSD should not be applicable to Gibraltar, dividends paid by a Luxembourg subsidiary[44] to its parent company incorporated and subject to corporate tax in Gibraltar would be exempt if the Gibraltar company is a fully taxable collective entity which is subject to corporate income tax at a rate comparable to the Luxembourg corporate income tax (see point i) for more details) and is resident in a country with which Luxembourg has signed a double tax treaty. The GAAR also applies to this provision as from 2016.

One of the main differences between article 147 LITL (outbound distributions) and article 166 LITL (inbound distributions) is that the application of article 147 LITL is more restrictive in that it requires that the foreign parent company is resident in a country with which Luxembourg has signed a double tax treaty (which is not the case for Gibraltar).

Hence, considering that the two conditions are cumulative (i.e. comparability test and tax treaty) and that there is no tax treaty between Luxembourg and Gibraltar, a WHT of 15% should in principle apply on gross dividends paid by a Luxembourg subsidiary to its parent company resident in Gibraltar.

However, based on the Opinion of the Advocate General, the provisions of the European treaties are to apply to Gibraltar[45]. Gibraltar companies should therefore benefit from the freedom of establishment when such companies decide to incorporate subsidiaries in other Member States (e.g. Luxembourg). In this context, it is interesting to note that the corporate income tax in Bulgaria and Hungary is 10% and 9%, respectively. In addition, dividends paid by a Luxembourg subsidiary to its parent companies resident in Hungary and Bulgaria should in principle benefit from a WHT exemption (in application of Article 147 LITL), while such dividends should be subject to 15% WHT if distributed to a parent company resident in Gibraltar. In certain circumstances, one may demonstrate that parent companies resident in Bulgaria, Hungary or Gibraltar are in a comparable situation and should therefore benefit from the same tax treatment in Luxembourg (i.e. exemption of WHT on dividend payments).

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42 Provisions applicable to the exemption of qualifying capital gains.

43 See footnote 12.

44 SOPARFI fully subject to Luxembourg corporate income tax and municipal business tax.

45 See part 2.2.

(iii) Existence of an advance tax agreement regarding the applicability of the PSD to Gibraltar.

Given the uncertainty that has existed (and still exists) around the application of articles 166 LITL and 147 LITL to Gibraltar entities, Luxembourg taxpayers have most probably requested an advance tax agreement from the Luxembourg tax authorities in order notably to confirm that the PSD was applicable to Gibraltar, in the sense that a company incorporated and subject to corporate tax in Gibraltar should be treated as a company incorporated and subject to corporate tax in the United Kingdom. In such case, the discussion developed above regarding the comparability test and the existence of a tax treaty would become irrelevant.

Based on the Luxembourg 2020 budget law[46], taxpayers could rely on an advance tax agreement issued before 1 January 2015 for the last time in the context of tax returns related to the 2019 taxation year, provided that the advance tax agreement complied with the law in force. Taxpayers are no longer able to rely on advance tax agreements issued before 1 January 2015 for subsequent taxation years. Since this measure is not retroactive, the binding effect of advance tax agreements validating the application of the PSD to Gibraltar should not be put into question for previous tax years (i.e. tax years preceding 2020). If a taxpayer were to seek an advance tax agreement for taxation years subsequent to the 2019 taxation year, the taxpayer would have to file a new application[47], which could however not be based on the application of the PSD (see the above comments regarding potential grounds for the Luxembourg participation and WHT exemption of inbound and outbound qualifying income).

In the case where a taxpayer did not secure its position by filing an advance tax agreement with the tax authorities, based notably on the former communication of the Commission on the subject[48], it should be possible to argue that the taxpayer had, until the publication of the Decision, a legitimate expectation regarding the applicability of the PSD to Gibraltar[49].

(iv) 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 lists 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 taxpayers do not rely on the provisions of the Directive to exempt interest and royalties from withholding tax as 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[50] 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.

Finally, 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 Advocate General, 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.

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46 See article 5 of the 2020 Budget law of 20 December 2019.

47 Such filing should be done in accordance with the procedure set out by the law of 19 December 2014 and the newsletter released by the tax authorities on 3 December 2019 on the subject.

48 See paragraph 3.1.

49 Under the general principle of the law of legitimate expectations, it requires the administrative authority to comply with an attitude that it followed in the past. Several Luxembourg case laws from the Administrative court have been issued on the subject (see Pasicrisie, Bulletin de Jurisprudence Administrative 2015 point 79).

50 The Luxembourg tax consequences of such restructuring transactions should be analysed in detail in order to conclude on the existence or not of adverse corporate tax impact.

04 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.

However, the Decision does not mean that an EU Member State may not apply its local participation exemption regime or its WHT exemption regime to companies incorporated in Gibraltar.

In the case of Luxembourg, articles 147 and 166 LITL may provide for additional opportunities and challenges to apply the Luxembourg participation exemption rules (apart from the PSD) on dividends, capital gains (for corporate income tax and municipal business tax purposes) and on investments (for net wealth tax purposes) made in or from Gibraltar.

The impact of the Decision on Directive 2009/133/EC (mergers, divisions, partial divisions, transfers of assets and exchanges of shares) as implemented into Luxembourg law (see articles 22 bis, 170 bis and 170 ter LITL) should also be carefully reviewed before any restructuring steps involving Luxembourg and Gibraltar entities are taken.

As usual in tax matters, a one fits-all approach is not recommended and a careful tailor-made review of the envisaged transaction(s) should be considered before engaging into any corporate implementation steps in order to avoid unnecessary costs and wasting time.

Prior results do not guarantee similar outcome. This publication was not designed to provide tax or legal advice and it does not substitute for the consultation with a tax or legal expert.

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