Case C-257/20

Summary of the request for a preliminary ruling pursuant to Article 98(1) of the Rules of Procedure of the Court of Justice

Date lodged:

9 June 2020

Referring court:

Varhoven administrativen sad (Bulgaria)

Date of the decision to refer:

4 May 2020

Appellant:

Viva Telekom Bulgaria EOOD

Defendant:

Direktor na Direktsia Obzhalvane i danachno-osiguritelna praktika (Director of the Directorate of Appeals and Tax and Social Insurance Practices), Sofia

Subject matter of the main proceedings

Appeal in cassation against the judgment of the Administrativen sad (Administrative Court) dismissing proceedings brought against a tax audit notice assessing a tax liability on the grounds of tax evasion in connection with an interest-free loan granted to a commercial company by its sole shareholder. The dispute between the parties concerns how the loan should be reported, that is whether it should be reported as a financial liability or as an equity instrument.

Subject matter and legal basis of the reference

Request for a preliminary ruling in accordance with Article 267 TFEU on the interpretation of Article 5(4) and Article 12(b) TEU, Articles 49 and 63 TFEU, Article 47 of the Charter of Fundamental Rights of the European Union, Article 4(1)(d) of Directive 2003/49/EC, Article 3(h) to (j), Article 5(1)(a) and (b),

Article 7(1) and Article 8 of Directive 2008/7/EC and Article 1(1)(b) and (3) and Article 5 of Directive 2011/96/EU.

Questions referred

1 Does national legislation such as that enacted in Article 16(2), point 3, of the Zakon za korporativnoto podohodno oblagane (Bulgarian Law on Corporation Tax, 'the ZKPO') conflict with the principle of proportionality enshrined in Article 5(4) and Article 12(b) of the Treaty on European Union and the right to an effective remedy and to a fair trial enshrined in Article 47 of the Charter of Fundamental Rights of the European Union?

2 Are interest payments in accordance with Article 4(1)(d) of Directive 2003/49/EC profit distributions to which Article 5 of Directive 2011/96/EU applies?

3 Does the rule laid down in Article 1(1)(b) and (3) and Article 5 of Directive 2011/96/EU apply to payments pursuant to an interest-free loan, which becomes due 60 years after the loan contract was entered into, and which is covered by Article 4(1)(d) of Directive 2003/49/EC?

4 Does national legislation such as that enacted in Article 195(1) and Article 200(2) of the ZKPO and Article 200a(1) and (5), point 4, of the ZKPO (repealed), as amended, which applied from 1 January 2011 to 1 January 2015, and Article 195(1), (6), point 3, and (11), point 4, of the ZKPO, as amended on 1 January 2015, and a taxation practice according to which unpaid interest on an interest-free 60-year loan granted on 22 November 2013 to a resident subsidiary by a parent company registered in a different Member State is subject to withholding tax conflict with Article 49 and Article 63(1) and (2) of the Treaty on the Functioning of the European Union, Article 1(1)(b) and (3) and Article 5 of Directive 2011/96/EU and Article 4(1)(d) of Directive 2003/49/EC?

5 Does national legislation such as that enacted in Article 16(1) and (2), point 3, and Article 195(1) of the ZKPO on the taxation at source of fictitious interest income on an interest-free loan granted to a resident company by a company in another Member State which is the borrower's sole shareholder conflict with Article 3(1)(h) to (j), Article 5(1)(a) and (b), Article 7(1) and Article 8 of Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital?

6 Does the transposition of Directive 2003/49/EC in Article 200(2) and Article 200a(1) and (5), point 4, of the ZKPO in 2011, that is prior to expiry of the transposition period laid down in point 3 of the section on taxation in Annex VI to the Act and the Protocol to the Treaty concerning the accession of the Republic of Bulgaria to the European Union, which sets a tax rate of 10% rather than the maximum rate of 5% prescribed in the Act and the Protocol to the Treaty concerning the accession of the Republic of Bulgaria to the European Union, infringe the principles of legal certainty and legitimate expectation?

EU legislation and case-law

Treaty on European Union: Article 5(4), Article 12(b) and Article 19(1)

Treaty on the Functioning of the European Union: Articles 49 and 54, Article 56(1), Article 63 and Article 65(1)(b) and (3)

Charter of Fundamental Rights of the European Union: Article 47(1)

Protocol concerning the conditions and arrangements for admission of the Republic of Bulgaria and Romania to the European Union: Article 20 and Annex VI, Section 6, point 3

Act concerning the conditions of accession of the Republic of Bulgaria and Romania and the adjustments to the Treaties on which the European Union is founded: Article 23 and Annex VI, Section 6, point 3

Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States: First and tenth recitals, Article 1(1), Article 4(1) and Article 5

Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital: Sixth and ninth recitals, Article 3(h) to (j), Article 5(1)(a) and (b), Article 7(1) and (3) and Article 8(3)

Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States: Article 1(1)(b), (2) and (3), Article 5 and Article 9

Judgment of the Court of 5 February 1991, *Trave-Schiffahrtsgesellschaft*, C-249/89, EU:C:1991:39

Judgment of the Court of 11 November 1999, *Henkel Hellas*, C-350/98, EU:C:1999:552

Judgment of the Court of 13 March 2007, *Test Claimants*, C-524/04, EU:C:2007:161

Judgment of the Court of 17 September 2009, *Glaxo Wellcome*, C-182/08, EU:C:2009:559

Judgment of the Court of 19 November 2009, *Commission* v *Italy*, C-540/07, EU:C:2009:717

Judgment of the Court of 16 June 2011, *Logstor*, C-212/10, EU:C:2011:404

Judgment of the Court of 31 May 2018, *Hornbach-Baumarkt*, C-382/16, EU:C:2018:366

Relevant provisions of national law

Zakon za korporativnoto podohodno oblagane (Bulgarian Law on Corporate Income Tax, 'the ZKPO'):

'Article 16. (1) … Where one or more transactions, including between unrelated persons, are conducted on terms that result in tax evasion, those transactions and certain of their terms and legal form shall be disregarded for the purpose of determining the basis for assessment, and the basis for assessment that would apply to a similar transaction conducted in the normal course of business at arm's length which aims to achieve the same financial result without resulting in tax evasion shall apply.

(2) The following also qualifies as tax evasion:

…

3. Borrowing or lending at an interest rate that is different from the standard market interest rate at the time of the transaction, including interest-free loans or other temporary financial assistance provided free of charge and the issuance of loans or the repayment of non-operating loans on own account.'

'Article 20 The rate of corporation tax is 10%.'

'Article 195(1) … Domestic income generated by foreign legal entities … shall be subject to withholding tax, payment of which shall extinguish the tax liability.

(2) The tax referred to in paragraph 1 shall be withheld by the legal entities registered in Bulgaria … which make payments to the foreign legal entities.

…

(6) The following shall be exempt from withholding tax:

…

3. (… effective from 1 January 2015) Interest income …, subject to the requirements of paragraphs 7 to 12;

…

(7) (… effective from 1 January 2015) Interest income … shall be exempt from withholding tax, provided that:

…

(11) (… effective from 1 January 2015) Paragraphs 7, 8, 9 and 10 shall not apply to:

1. Income from profit distributions or capital repayments.

…

4. Income from debt-claims which contain no provision for repayment of the principal amount or where the repayment is made more than 50 years after the date of issue.

…

7. Income from transactions, the primary reason or one of the primary reasons for which is tax evasion or tax avoidance.'

'Article 199. (1) The basis for assessment of the withholding tax on the income referred to in Article 195(1) is gross income.'

'Article 200. …

(2) (… effective from 1 January 2011) The rate of tax on the income referred to in Article 195 is 10%, except where Article 200a applies.'

'Article 200. …

(2) (… effective from 1 January 2015) The rate of tax on the income referred to in Article 195 is 10%.'

'Article 200a. (… effective from 1 January 2011, as amended and supplemented … effective from 1 January 2014) (1) The rate of tax on interest income … is 5%, provided that:

…

(5) Paragraphs 1 to 4 shall not apply to:

1. Income from profit distributions or capital repayments.

2. Income from debt-claims which carry a right to participate in the debtor's profits.

3. Income from debt-claims which entitle the creditor to exchange his right to interest for a right to participate in the debtor's profits.

4. Income from debt-claims which contain no provision for repayment of the principal amount or where the repayment is made more than 50 years after the date of issue; ….'

‘Article 200a. (… repealed … with effect from 1 January 2015).’

Brief summary of the facts and procedure

7 On 22 November 2013, Viva Telekom Bulgaria EAD (‘the borrower’) and its sole shareholder, InterV Investment S.a.r.l., a legal entity registered in Luxembourg (‘the lender’) entered into a loan agreement for the sum of EUR 145 700 910.32 (BGN 284 966 211) which took effect that same day. The agreement provided for the borrower to use the loan, to repay debts and loans, tax and transaction costs.

8 It was provided that the loan was interest free and would mature 60 years after disbursement. The parties agreed that the borrower’s obligation to repay the loan could lapse if the lender decided to convert the outstanding loan to a contribution in kind to the borrower’s equity in accordance with the procedure provided for in the agreement. In that case, the borrower is required to state its intention to contribute the loan as a contribution in kind to its equity by sending notice to that effect to the lender. The lender must decide whether an application should be submitted to the Trade Register and an expert appointed to evaluate the loan, and must present documents showing that the loan has been reported as a debt-claim payable by the borrower to the lender. Once the evaluation has been prepared, the lender, in its capacity as the borrower’s sole shareholder, must pass a resolution increasing the borrower’s registered share capital by issuing new shares in accordance with the valuation, reporting the entire new share issue as capital and amending the borrower’s memorandum and articles of association. These resolutions must be entered in the Trade Register. The procedure for contributing the debt-claim from the loan as a contribution had not been carried out when the tax audit notice referred to below was issued.

9 On 14 February 2014, the borrower was deleted from the Trade Register and the company Viva Telekom Bulgaria EOOD, of which InterV Investment S.a.r.l. is the sole shareholder, was entered as its successor in title.

10 By a tax audit notice dated 16 October 2017 and covering the period from 14 February 2014 to 31 March 2015, the Teritorialna direktsia na Natsionalna agentsia za prihodite, Sofia, (Regional Directorate of the National Revenue Agency, Sofia) assessed withholding tax of BGN 1 831 926.74 on the basis of Article 16(2), point 3, and Article 195 of the ZKPO, plus interest of BGN 544 079.86 on the interest income of the foreign entity InterV Investment S.a.r.l. The tax authority contended that the performance of the aforesaid loan agreement had resulted in tax evasion, as the borrower had not paid any instalments or interest on the loan.

11 The objection to the tax audit notice lodged in the administrative procedure was dismissed. By judgment of 29 March 2019, the Administrativen sad Sofia grad (Administrative Court, Sofia) also dismissed the action lodged against that decision, stating as its reason that the loan granted formed part of the borrower’s assets rather than its equity and that the borrower had gained a financial advantage

by not paying loan interest, as a result of which the lender had sustained a financial loss in the amount of that unpaid interest, and it dismissed the appellant's line of argument that, as the borrower had reported a financial loss in the two years audited, it had no withholding tax liability. It held that, as the loan had not been converted to capital in accordance with the loan agreement, the tax authority had lawfully determined the standard market interest under Article 16(2), point 3, of the ZKPO and had assessed Viva Telekom Bulgaria's withholding tax liability under Article 195 of the ZKPO at that amount.

12 Viva Telekom Bulgaria lodged an appeal against that judgment before the referring court.

Principal arguments of the parties to the main proceedings

13 The appellant contends that the withholding tax was assessed on fictitious interest income and the proven commercial motives for the granting of the interest-free loan were disregarded in the proceedings; that, when the loan was granted, the lender was its sole shareholder and the borrower had no funds to pay interest on the loan; and that, in its opinion, Article 16(2) point 3, of the ZKPO infringes the case-law of the Court of Justice of the European Union, as it denies the parties to the loan agreement the opportunity to prove admissible commercial reasons for the granting of the interest-free loan.

14 The appellant cites the reasons given in paragraphs 11 to 14 of the judgment in case C-249/89, in which the Court found that the granting of an interest-free loan for the purposes of Directive 2008/7/EC qualifies as a contribution of capital, as it increases the assets of the company benefiting from it and the value of its shares in that, by saving interest expenditure, the company benefiting from the loan increases the value of its shares.

15 In the alternative, the appellant argues that the loan in question was a contribution of capital within the meaning of Article 3(h) to (j) of Directive 2008/7/EC which, according to Article 5 of that Directive, is not subject to indirect tax.

16 The respondent claims that, although restrictions on the free movement of capital and payments are prohibited, Article 65(1)(a) TFEU states that this is without prejudice to the right of the Member States to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested. It cites paragraph 81 of the judgment in case C-524/04, in which the Court found that the fact that a resident company has been granted a loan by a non-resident company on terms which were not at arm's length allows the Member State in which the borrowing company is resident to verify if the transaction represents, in whole or in part, a purely artificial arrangement, the essential purpose of which is to circumvent the tax legislation of that Member State.

17 The respondent also cites the judgment in case C-382/16, in which the Court found that there is nothing to preclude national legislation under which the income of a company resident in a Member State, which granted to a company established in another Member State with which it has a relationship of interdependence advantages under terms that depart from those that would have been agreed on by unrelated third parties under the same or similar circumstances, must be calculated as it would have been if the terms which would have been agreed with unrelated third parties had been applicable.

Brief summary of the basis for the reference

First question

18 Article 16(2), point 3, of the ZKPO enacts an irrefutable presumption of tax evasion where an interest-free loan is granted between persons related to or independent of each other and denies the lender and the borrower the opportunity to refute the presumption of tax evasion. The Court held, in paragraph 73 of the judgment in case C-524/04, that the mere fact that a resident company is granted a loan by a related company which is established in another Member State cannot be the basis of a general presumption of abusive practices and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty. Where an interest-free loan is granted between unrelated persons, the intention to evade tax can reasonably be presumed. Where related persons enter into an interest-free loan agreement, there may be commercial reasons, in conjunction with the interests of the group of companies, for entering into an interest-free loan agreement. Article 16(2), point 3, of the ZKPO precludes the legal relevance of proof of the financial or commercial reasons for an interest-free loan. The irrefutable presumption has the same procedural significance as for interest-free loans between persons who are independent of each other.

Questions 2 to 4

19 According to Article 4(1)(d) of Directive 2003/49/EC, the source State need not ensure the benefits of the Directive to ‘payments from debt-claims which contain no provision for repayment of the principal amount or where the repayment is due more than 50 years after the date of issue’. The loan matures 60 years after the agreement took effect and falls within the scope of Article 4(1)(d) of Directive 2003/49/EC.

20 That Directive was transposed into national law under the law amending the ZKPO, which entered into force on 1 January 2011 and which amended Article 200(1) of the ZKPO. According to the new version of that provision, the tax rate on the income referred to in Article 195 is 10%, other than in the cases listed in Article 200a. That same amending law inserted a new Article 200a, paragraph 3 of which states that paragraphs 1 and 2 do not apply to payments from debt-claims which contain no provision for repayment of the principal

amount or where the repayment is made more than 50 years after the date of issue. Article 200a(3), points 1 to 3, of the ZKPO transpose Article 4(1)(a) to (c) of Directive 2003/49/EC, following which, according to Article 16(1) and (2), point 3, Article 195(1), Article 200(2) and Article 200a(1) and (5), point 4, of the ZKPO, the rate of withholding tax on income generated by a foreign company registered in another Member State received from a related resident person for debt-claims which contain no provision for repayment of the principal amount or where the repayment is made more than 50 years after the date of issue was 10% in 2014.

21 A new law amending the ZKPO, repealing Article 200a and amending Article 200(2) by setting the tax rate for the income referred to in Article 195 at 10% entered into force on 1 January 2015. Article 195(6) was also amended by inserting a new point 3 exempting interest income from withholding tax subject to the requirements of the new paragraphs 7 to 12. Paragraph 7 lists the requirements governing the exemption of interest income from withholding tax. It follows from Paragraph 11, point 4, that paragraph 7 does not apply to income from debt-claims which contain no provision for repayment of the principal amount or where the repayment is made more than 50 years after the date of issue. Paragraph 11, points 1 to 3, transpose the remaining requirements of Article 4 of Directive 2003/49/EC, following which, according to Article 195(1), (6), point 3, and (11), point 4, and Article 200(2) of the ZKPO, the rate of withholding tax on income generated by a foreign company registered in another Member State received from a related resident company for debt-claims which contain no provision for repayment of the principal amount or where the repayment is made more than 50 years after the date of issue was 10% in 2015.

22 According to Article 1(1)(b) of Directive 2011/96/EC, the Member States apply the Directive to distributions of profits by companies of that Member State to companies of other Member States of which they are subsidiaries. According to Article 1(2), the Member States do not apply the Directive to non-genuine arrangements whose main purpose is to obtain a tax benefit. According to Article 1(3) of Directive 2011/96/EC, for the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. According to Article 5 of Directive 2011/96, profits which a subsidiary distributes to its parent company are exempt from withholding tax.

23 The Court decided in paragraph 89 of the judgment in case C-524/04 that the Member State in which the company is resident that pays interest on a loan to its parent company resident in a different Member State can treat interest paid by the resident subsidiary as a distribution of profits.

24 The Court held in paragraph 54 of the judgment in case C-382/16 that, in a situation where the expansion of the business operations of a subsidiary requires additional capital due to the fact that it lacks sufficient equity capital, there may be

commercial reasons for a parent company to agree to provide capital on non-arm's-length terms.

The fifth question

25 According to Article 3(h) [to (j)] of Directive 2008/7/EC, contributions of capital include: 'an increase in the assets of a capital company through the provision of services by a member which does not entail an increase in the company's capital, but which does result in a variation in the rights in the company or which may increase the value of the company's shares', 'a loan taken up by a capital company, if the creditor is entitled to a share in the profits of the company' and 'a loan taken up by a capital company with a member or a member's spouse or child, or a loan taken up with a third party, if it is guaranteed by a member, on condition that such loans have the same function as an increase in the company's capital'. According to Article 5(1)(a) and (b) of that Directive, the Member States shall not subject capital companies to any form of indirect tax on 'contributions of capital' or 'loans, or the provision of services, occurring as part of contributions of capital'.

26 The Court stated in paragraph 15 of the judgment in case C-249/89 that the granting of an interest-free loan to a company by one of its members constitutes a transaction tantamount to a contribution of capital under Article 4(2)(b) of Directive 69/335, as replaced by Directive 2008/7/EC. According to the correlation table, Article 3(g) to (j) of Directive 2008/7/EC corresponds to that provision. The Court found at paragraph [12] of that judgment that the granting of an interest-free loan allows the company to have capital available without having to bear its cost and, in paragraph 14, that the granting of an interest-free loan allows the company to have capital available without having to bear its cost and must therefore be regarded as likely to increase the value of the company's shares.

27 In light of that judgment, the interest-free loan granted to the appellant meets the definition of a contribution of capital within the meaning of Article 3(1)(h) to (j) of Directive 2008/7/EC.

28 The Court found at paragraph 20 of the judgment of 11 November 1999 in case C-350/98 that the nature of a tax, duty or charge must be determined by the Court according to the objective characteristics by which it is levied, irrespective of its classification under national law.

Question 6

29 According to the Protocol concerning the conditions and arrangements for admission of the Republic of Bulgaria and Romania to the European Union and the Act concerning the conditions of accession of the Republic of Bulgaria, the latter 'shall be authorised not to apply the provisions of Article 1 of Directive 2003/49/EC up to 31 December 2014. During that transitional period, the rate of tax on payments of interest or royalties made to an associated company of another

Member State or to a permanent establishment situated in another Member State of an associated company of a Member State must not exceed 10% until 31 December 2010 and must not exceed 5% for the following years until 31 December 2014'.

The rules laid down in Article 200(2) and Article 200a(1) and (5), point 4, of the ZKPO that applied for 2014 conflict with the maximum tax rate of 5% laid down in Annex VI, Section 6, point 3, of the Protocol and Annex VI, Section 6, point 3, of the Act.