General Court of the European Union
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Press and Information

Judgment in Cases T-516/18 Luxembourg v Commission and T-525/18 Engie, Engie Global LNG Holding Sàrl and Engie Invest International SA v Commission

Tax rulings granted by Luxembourg to companies in the Engie group: the General Court finds the existence of a tax advantage

It states that preferential tax treatment is predominantly the result of the non-application of a national measure relating to abuse of law

Between 2008 and 2014, the Luxembourg tax authorities adopted two sets of tax rulings ('the contested tax rulings') in connection with intra-group financing structures relating to the transfer of activities between companies of the Engie group resident in Luxembourg.

In broad outline, the transactions carried out under each structure are implemented in three successive stages. First, a holding company transfers shares to a subsidiary. Secondly, in order to finance the shares transferred, that subsidiary takes out an interest-free mandatorily convertible loan (ZORA) with an intermediary. Besides the fact that the loan granted generates no periodic interest, the subsidiary that has received the ZORA repays the loan, upon its conversion, by issuing shares the amount of which is equivalent to the nominal amount of the loan, plus a premium representing, in essence, all of the profits made by the subsidiary during the term of the loan (ZORA accretions). Thirdly, the intermediary finances the loan granted to the subsidiary by entering into a prepaid forward sale contract with the holding company under which the holding company pays to the intermediary an amount equal to the nominal amount of the loan in exchange for the acquisition of the rights to the shares that the subsidiary will issue on conversion of the ZORA. Therefore, if the subsidiary makes profits during the life of the ZORA, the holding company will own the right to all the shares issued, which will incorporate the value of any profits made as well as the nominal amount of the loan.

Those structures were endorsed by the contested tax rulings. For tax purposes, under the contested tax rulings, only the subsidiary is taxed on a margin agreed with the Luxembourg tax administration. After requesting information about the contested tax rulings from the Luxembourg authorities, the Commission initiated a formal investigation procedure at the end of which it determined that the result of the structures approved by the tax administration is that almost all of the profits made by the subsidiaries established in Luxembourg have not been taxed. Consequently, in a decision adopted in 2018 ('the contested decision'), the Commission concluded that the contested tax rulings constitute illegal State aid that is incompatible with the internal market, which must be recovered from the recipients by the Luxembourg authorities.

Luxembourg (Case **T-516/18**) and the **Engie group** companies (Case **T-525/18**) brought an action for annulment of the contested decision before the General Court of the European Union.

In its judgment, the General Court approves the Commission's approach, when presented with a complex intra-group financing structure, which entails looking at the economic and fiscal reality, rather than a formalistic approach that takes in isolation each of the transactions under the structure. In addition, the General Court finds that the Commission was right to determine that a selective advantage was conferred as a result of the non-application of national provisions relating to abuse of law.

The General Court's assessment

Direct taxation being a matter that falls within the exclusive competence of the Member States, the General Court noted that, when examining whether the contested tax rulings comply with State aid rules, the Commission did not engage in **any 'tax harmonisation in disguise'** but exercised the power conferred on it by EU law. Since the Commission is competent to ensure compliance with Article 107 TFEU, it cannot be accused of having exceeded its powers when it examined the contested tax rulings in order to ascertain whether they constitute State aid and, if so, whether that State aid is compatible with the internal market. In the present case, the General Court notes that, when investigating whether the contested tax rulings comply with State aid rules, the Commission carried out an assessment only of 'normal' taxation, defined by Luxembourg tax law as applied by the Luxembourg tax authorities.

The General Court also rejects the pleas alleging, in essence, errors of assessment and of law in the identification of a selective advantage giving rise to State aid.

When examining those pleas, the General Court, first of all, rejects the arguments alleging confusion of the conditions for finding an advantage and for demonstrating the selectivity of the contested tax rulings. In that regard, the General Court points out that, having regard to the fiscal nature of the contested tax rulings, those two conditions may be assessed simultaneously. In tax matters, the examination of an advantage overlaps with the examination of selectivity in so far as, for those two conditions to be satisfied, it must be shown that the contested tax measure leads to a reduction in the amount of tax which would normally have been payable by the recipient of the measure under the ordinary tax regime and, therefore, applicable to other taxpayers in the same situation. In the present case, the General Court notes that the Commission sought to demonstrate that the contested tax rulings led to a reduction in the amount of tax which would normally have been payable under the ordinary tax regime and that, consequently, those measures constitute a **derogation from tax rules applicable to other taxpayers in the same factual and legal situation**.

Next, the General Court rejects the arguments relating to the absence of a selective advantage at the level of the holding companies in the light of a narrow reference framework established on the basis of Luxembourg tax provisions relating to the taxation of profit distributions and the participation exemption. [1] As regards the definition of that reference framework, after stating that it is apparent from an analysis of those tax provisions that the participation exemption is applicable only to income which has not been deducted from the taxable income of subsidiaries, the General Court finds that the Commission did not err in law in determining that **the participation exemption at the level of a parent company is dependent on the taxation at the level of its subsidiary of profits distributed by that subsidiary**. As regards the identification of a derogation from the defined reference framework, the General Court states that, contrary to a formalistic approach that entails taking in isolation each of the transactions that make up the sophisticated financing structure, it is important to go beyond the legal form in order to look at the **economic and fiscal reality** of the structure. In the present case, the General Court notes that the contested tax rulings approve various transactions which constitute a system for implementing, in a circular and interdependent fashion, the transfer of a business activity and its financing between three companies belonging to the same group. Those transactions were designed to be implemented in three **successive but interdependent** stages, involving the intervention of a holding company, an intermediary and a subsidiary. In those circumstances, the General Court considers that the Commission was entitled to determine that the Luxembourg tax administration **derogated from the reference framework** by confirming the exemption, at the level of the holding companies, of participations which correspond, from an economic perspective, to an amount that was deducted, as part of an intra-group financing structure, as expenses at the level of the subsidiaries. [2] In the light of the links established by the Commission within that structure, the General Court finds that the Commission did not err in law by looking at the combined effect, at the level of the holding companies, of the deductibility of income at the level of a subsidiary and the subsequent exemption of that income at the level of its parent company.

[1] Articles 164 and 166 of the loi concernant l'impôt sur le revenu (Law on income tax).
[2] The ZORA accretions were deducted by the subsidiary as expenses.

After rejecting the arguments alleging, first, that the Commission had not established an infringement of the national tax provisions and, secondly, that no companies had been identified which would be refused identical tax treatment for an identical financing structure, the General Court concludes that the Commission has demonstrated the **selectivity of the contested tax rulings** in the light of the narrow reference framework.

In the contested decision, the Commission also investigated the selectivity of the contested tax rulings in the light of the provision relating to **abuse of law**, as **an integral part of the Luxembourg corporate income tax system**. In view of the unprecedented nature of the reasoning seeking to demonstrate the selectivity of the contested tax rulings, the General Court considers it appropriate to examine the merits of the arguments that were put forward against it. In that regard, in so far as the Commission ascertained that the **criteria laid down by Luxembourg law** in order to find that there has been an abuse of law were **met**, [3] the General Court finds that it cannot be disputed that the Engie group received **preferential tax treatment** owing to the **non-application**, in the contested tax rulings, of the provision relating to abuse of law. In the light of the objective pursued by the provision relating to abuse of law, namely to combat abusive practices in tax matters, Engie and, in particular, the holding companies are in the same factual and legal situation as all Luxembourg taxpayers, who cannot reasonably expect to benefit as well from the non-application of the provision relating to abuse of law in cases where the conditions for its application have been satisfied. Consequently, the General Court holds that the Commission demonstrated to the requisite legal standard a derogation from the reference framework comprising the provision relating to abuse of law.

NOTE: An appeal, limited to points of law only, may be brought before the Court of Justice against the decision of the General Court within two months and ten days of notification of the decision.

NOTE: An action for annulment seeks the annulment of acts of the institutions of the European Union that are contrary to European Union law. The Member States, the European institutions and individuals may, under certain conditions, bring an action for annulment before the Court of Justice or the General Court. If the action is well founded, the act is annulled. The institution concerned must fill any legal vacuum created by the annulment of the act.

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[3] The conditions for finding an abuse of law are, first, use of a private law legal form, secondly, a reduction in the tax burden, thirdly, use of an inappropriate legal form and, fourthly, the absence of non-tax related reasons.