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EU TAX ALERT

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EU COURT OF JUSTICE
CASE C-257/20, VIVA TELEKOM BULGARIA

AG ATHANASIOS RANTOS OPINED THAT BULGARIAN LEGISLATION ENTAILING A WITHHOLDING TAX ADJUSTMENT ON DEEMED INTEREST PAYMENTS IS NOT CONTRARY TO EU FUNDAMENTAL FREEDOMS AND DIRECTIVES

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On 30 September 2021, Advocate General ("**AG**") Athanasios Rantos delivered his opinion in Case C-257/20, Viva Telekom Bulgaria v. Bulgarian Tax Administration, which originates from a request for a preliminary ruling brought by the Bulgarian Supreme Administrative Court.

Facts of the case

Viva Telekom Bulgaria EOOD ("**Viva Telekom**") was provided by its Luxembourg shareholder ("**InterV**") with an interest free loan, which had a maturity of 60 years and which was at any time convertible into an equity contribution. The aim of the loan was to allow Viva Telekom to extinguish an outstanding debt to a third-party bank, which was taken for the purposes of financing the acquisition by InterV of the controlling participation into a Bulgarian telecom operator. As the loan had not been converted, Bulgarian tax authorities have challenged that, according to Article 16(2)3 of the Corporate Income Tax Ac, the interest free loan had to be remunerated with a market interest rate of approximately 5% per year and have consequently applied a tax adjustment on the deemed interest payments in the form of withholding tax ("**WHT**").

The Supreme Administrative Court ("**SAC**") referred to the Court of Justice of the European Union ("**CJEU**") a number of questions, mainly dealing with the compatibility of article 16(2)3 of Corporate Income Tax Act with the Interest and Royalties Directive (2003/49/EC of 3 June 2003 also referred as "**IRD**"), the Parent Subsidiary Directive (2011/96/EU of 30

November 2011, also referred as "**PSD**"), as well as with Articles 49 and 63 of the Treaty on the Functioning of the European Union ("**TFEU**"), dealing respectively with the free movement of capital and the freedom of establishment.

AG opinion

AG concluded that neither the IRD, nor the PSD could apply to the case at stake. With regard to the IRD, AG argued: that (i) notional interest cannot be regarded as "*interest payments*'" within the meaning of Article 1(1) and Article 2(a) of that Directive; that, (ii) in any event, Bulgaria opted to apply the derogation provided for in Article 4(1)(d), which excludes from its scope '*payments from debt-claims […] for which repayment is due more than 50 years after the date of issue*'; and that (iii) the application of a WHT on notional interest would not lead to double taxation as deemed interest are not likely to be taxed in Luxembourg. With regard to the PSD, AG opined that – in the absence of an actual payment between the entities involved – notional interest cannot be regarded as a "*distribution of profits*" under Article 5 of that Directive.

With regard to the compatibility of Bulgarian legislation with Articles 49 and 63 TFEU, AG argued that, while entailing a discriminatory treatment in cross-border situations, Bulgarian legislation is in principle justified by overriding reasons in the public interest, namely (i) the need to ensure a balanced allocation of taxing rights between Member States, as it prevents profits generated in the relevant Member State from being transferred outside its tax jurisdiction through transactions not in accordance with the arm's length principle and (ii) the fight

against tax avoidance. AG relied on the CJEU's prior case law (in particular, C-524/04, *Thin Cap Group Litigation*; C-201/05, *CFC and Dividend Group Litigation*) and held that – subject to verification by the national court – Bulgarian legislation does not seem to exceed what is necessary to attain those objectives, as taxpayers appear to be given the opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification for the relevant transactions.

Commentaries

If confirmed by the CJEU, the opinion is going to have a significant impact on tax audit practice in EU Member States, especially as it characterizes notional interest and dividend payments as falling outside the scope of the IRD and PSD. The argument developed by AG, however, does not directly apply to the (different) case of constructive interest and dividends, where actual payments are recharacterized as such for tax purposes
Moreover, AG considers that the application of a WHT on the notional interest (and dividends) by the source Member State would not generally trigger double taxation and, thus, would be in line with the objective of the Directives. This conclusion, though, is questionable whenever the source State does not allow the notional payment to be deducted from the business profits of the deemed payor under that State's ordinary tax rules.